# CASE PROBLEMS IN AUDITING

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# PREFACE

This book on *Case Problems in Auditing* has been prepared in an endeavor to help fill a conspicuous present deficiency in the teaching of courses in elementary auditing, i.e., auditing *cases* and *problems*. This deficiency is one of long standing. There has long been a lack of auditing materials to supplement text and classroom discussions—materials involving the utilization and application of auditing principles, materials which the student might *work upon* for the purpose of acquiring, within limits, some of the basic "know-how" of auditing practices and procedures; and still other materials calling for intelligent and challenging decisions. It is the purpose of this book to present materials to meet these needs.

The cases and problems of this book are not intended to serve as the sole teaching instrument of the classroom or of the office of the practicing auditor. In combination with lectures, discussions, and a standard auditing text, however, the cases and problems of this book should be valuable teaching aids.

The cases and problems are realistic and stimulating. Their practicality should make them of lively interest to student, teacher, and the active professional auditor—especially the auditor who operates a staff training program.

Seven problems used in this book have previously appeared in professional C.P.A. examinations. Acknowledgment is due the American Institute of Accountants for the use of these problems (marked with an asterisk).

These cases may also be used to encourage students to improve their writing skills. The preparation of working papers, written answers to case questions and, finally, an audit report, are procedures which contribute to writing improvement. In this connection, the last case of the book (the Caroline Dress Company) minimizes procedural details in favor of maximizing the work of *writing* an audit report—the report by which the auditor himself is judged. This case should be assigned early in the school term for interim work as the term progresses. The complete audit report should be called for at the end of the term.

ARNOLD W. JOHNSON

*Syracuse, New York*
*September, 1950*

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# CASE PROBLEMS IN AUDITING

# 1. PROFESSIONAL ETHICS AND RESPONSIBILITIES

## Arcadian Corporation

Certified financial statements relating to the year 19— were prepared for the Arcadian Corporation by W. Ross McCain, certified public accountant. These statements were used in the annual report of the corporation and in making application for a loan of $100,000.00 from the Commercial Bank and Trust Co.

In passing upon the loan, officers of the bank asked for a set of certified financial statements prepared by another accountant. They objected to the statements submitted on the grounds that W. Ross McCain had not acted in a truly independent capacity. It was pointed out that Mr. McCain was greatly in debt to the president of the Arcadian Corporation. The fee for the audit contract was $5,000.00 or 1½% of the net income of the corporation, whichever was greater. It was pointed out also that the January 1 inventory of the corporation had been valued on the first-in, first-out basis, and the December 31 inventory had been valued on the last-in, first-out basis. No mention of this change in the method of inventory valuation was made in the report of Mr. McCain. Also a $100,000.00 loan to the president of the Arcadian Corporation was included simply as part of Notes Receivable. The auditor agreed that these items might have been better classified in the statements. This was not done, however, because of insistence by officers of the corporation that the items be shown in the manner in which they finally appeared in the auditor's statements.

**Required:**

In your opinion did Mr. McCain act as an independent accountant in certifying the statements of the company? Why? Explain carefully.

## The Henry P. Davis Company

The Henry P. Davis Company was a corporation whose outstanding 87,143 shares of no-par common stock was closely held. Mr. Henry P. Davis was president and owned 45,488 shares; the remaining stock was held by seven other stockholders. The company had operated profitably for many years, especially over the past five years. It was generally held that the success of the company, in large part, was creditable to the special managerial talents of Mr. Davis.

During the past calendar year, a bonus plan was inaugurated by the company for the purpose of additionally compensating Mr. Davis for his services. In your examination of the minute book of the corporation for January 17 (last year), you find the following to be the complete record of the bonus contract and its approval by the board of directors:

> In further recognition of the benefits conferred upon the Corporation by the valued managerial skill of Mr. Henry P. Davis, president, it is hereby directed that, in addition to his fixed annual salary (see minutes, December 9, 19—) Mr. Henry P. Davis be paid a special bonus at the close of the current calendar year. The amount of this bonus shall be $1\frac{1}{2}\%$ of the sales of the Company for the year in question or 5% of the net profits of the Corporation, whichever shall be greater. (NOTE.—While this motion was being discussed and approved, Mr. Davis turned the chairmanship over to Mr. Miller P. Tydings and left the room. After the motion had been approved, Mr. Davis returned to the room, thanked the directors for the bonus, and resumed his position as chairman.)

**Required:**

What questions present themselves in the incorporation of this bonus plan in your financial statements and audit report?

## Ralph Maxon, C. P. A.[1]

Ralph Maxon, a certified public accountant and a junior partner in the firm of Brown, Haber, Geller & Company, was indicted on forgery and conspiracy charges. Mr. Maxon was accused of "altering the records" and "completely rewriting the books" of Wally Antin, Inc., a dress manufacturing concern of 235 West 35th Street, New York City, in order to "conceal extortionate payments to the mobster Scarface Louie Lieberman."

District Attorney Frank S. Hogan stated that Maxon's activities were typical of the obstacles placed in the path of his office in its investigation of purported racketeering conditions in the garment section. It was "an attempt to obstruct and impede this inquiry" and it was "indicative of the difficulties encountered and illustrative of the criminal lengths resorted to in order to avoid disclosure of payment of tribute to gangsters for fear of violent reprisals."

He stated that not only were the records of the company falsified but even accountants' working papers and office copies of income tax returns were altered to correspond with them. He further stated that erasures were made and the words "commission" and "selling" were substituted for the word "protection."

On the other hand, the attorney for the defendant stated that there had been "no criminal intent" on the part of Mr. Maxon. He stated that Mr. Maxon "had been imposed on by his client, who told him he feared for his life."

**Required:**

What ethical questions are involved in this case? How should the difficulties confronting the accountant have been solved originally?

[1] *New York Times*, June 16, 1949, p. 56.

## Hershey Oil Company

The accounts of the Hershey Oil Company were being audited by you for the calendar year 19—. In the course of your examination, you found that the disbursements included five checks for $20,000.00 each, all payable to C. A. Hershey, president, and all charged to Miscellaneous Selling Expense. Supporting vouchers for these disbursements were examined and found to be properly authorized and signed. Explanatory details, however, were missing. On inquiry, the president explained in rather general terms that the cash in question was privately paid to certain public officials of the State Land Commission. It ultimately became clear to the auditors that payment of this money had been instrumental in the procurement of certain valuable oil lands from the State Land Commission at a purchase cost of $1,000,000.00.

Another voucher, also made out to the president, properly authorized and signed, was examined. This voucher, for $5,000.00, was charged to General Expense. From more or less evasive explanations it became clear that this money had been used in obtaining a field agent's approval of the company's income tax return for a previous calendar year.

You were unable to obtain further specific information on any of these vouchers. All of the vouchers, however, were properly approved and signed.

**Required:**

Would you include these disbursements in your statements as selling expense and general expense? How should the problem posed by these vouchers be handled by an auditor? If illegal, should the disbursements be included in your statements? Or reported to public officials? Discuss.

## Sanford P. Clark, C. P. A.

Mr. Sanford P. Clark was a certified public accountant of several years' standing. Recently he was asked by the board of directors of the Emerson Furniture Company (a retail merchandising business) to perform an audit of the company's accounts. The engagement, however, appeared to involve some questions of professional ethics which, Mr. Clark felt, deserved careful consideration.

In substance, the factual background for the audit was found in the unaudited balance sheet of December 31, 19—, and other information, as follows:

### EMERSON FURNITURE COMPANY

BALANCE SHEET, DECEMBER 31, 19—

*Assets*

| | | |
|---|---|---|
| Current Assets: | | |
| Cash | | $ 70,000.00 |
| Accounts Receivable | | 120,000.00 |
| Inventory | | 110,000.00 |
| | | $300,000.00 |
| Fixed Assets: | | |
| Property and Equipment (net) | | 100,000.00 |
| | | $400,000.00 |

*Equities*

| | | |
|---|---|---|
| Current Liabilities: | | |
| Accounts Payable | | $ 80,000.00 |
| 6% Notes Payable to First Central Bank | | 60,000.00 |
| 8% Notes Payable to Sanford P. Clark | | 40,000.00 |
| | | $180,000.00 |
| Net Worth: | | |
| Common Stock, $100.00 par | $100,000.00 | |
| Earned Surplus | 120,000.00 | 220,000.00 |
| | | $400,000.00 |

Mr. Clark had long been interested in the affairs of the Emerson Furniture Company and, by virtue of this interest and his ownership of 100 shares of the company's common stock, was a member of the company's board of directors. Over a period of years, the company had paid an average dividend of approximately 10%.

Mr. Clark's son-in-law, Stephen E. Chadwick, was chief accountant of the Emerson Furniture Company. Mr. Clark often gave counsel and advice to Mr. Chadwick and sometimes assisted him with his work at the end of the month when the volume of accounting work was heavy and the pressure for financial statements considerable.

The fee for the proposed audit engagement was to be $2,000.00 or, if the profits were more than $30,000.00, 10% of the audited figure for net profit.

**Required:**

Would it be proper for Mr. Clark to audit the accounts of the Emerson Furniture Company? Discuss fully the ethical questions which relate themselves to this case.

## Doctors Supply Company, Inc.

The Doctors Supply Company, Inc., was a corporation engaged in merchandising the special supplies needed by doctors and hospitals. Its outstanding capitalization consisted of $500,000.00 of common stock. Its officers and directors were:

| *Officers* | *Directors* | *Shares of Stock Owned* |
|---|---|---|
| John G. Patterson, President | John G. Patterson, M.D. | 1,000 |
| Solem P. Byrnes, Vice President | Solem P. Byrnes, M.D. | 800 |
| Robert E. Knox, Vice President | Robert E. Knox, M.D. | 700 |
| Henry J. McIntosh, Secretary | Henry J. McIntosh, LL.B. | 600 |
| Leslie P. Warren, Treasurer | Leslie P. Warren, M.B.A. | 500 |
| | Winn A. Gaines, Ph.D. | 500 |
| | James A. Scott, C.P.A. | 500 |
| | Borden W. Kramer, B.B.A. | 400 |
| | | 5,000 |

Acting under authority granted him by the board of directors, Dr. Patterson entered into arrangements with Mr. James A. Scott, a local certified public accountant, for a first audit of the accounts of the Doctors Supply Company, Inc., for the calendar year of 19—. It was mutually agreed that the audit fee was to be 2% of the net income of the business (after deduction of all other expenses but before deduction of income taxes) and that the fee was to be paid from the company's unissued capital stock ($100.00 par) at a price of 100. The bid price on the company's capital stock over the past calendar year ranged from 110 to 140. The current bid price was 150. The premium reflected in this price was a reflection of the company's excellent income and dividend record. On the average, about 80% of the company's annual net income was disbursed as dividends. However, only one dividend was disbursed each year; it was declared and disbursed subsequent to the final determination of earnings for any given calendar year.

The company's preliminary condensed profit and loss statement (for the past calendar year) prepared by one of Mr. Scott's staff accountants in February was:

| | | |
|---|---|---|
| Sales | | $1,000,000.00 |
| Cost of Sales: | | |
| Inventory, January 1, 19—, at cost | | $ 100,000.00 |
| Purchases | | 630,000.00 |
| | | $ 730,000.00 |
| Inventory, December 31, 19—, at cost | | 150,000.00 |
| | | $ 580,000.00 |
| Selling and General Expenses | $279,000.00 | |

| | | |
|---|---|---|
| Bonus to Officers | ? | |
| Audit Fee | ? | |
| Provision for Contingencies | 30,000.00 | |
| Net Profit (Before Income Taxes) | | $ |

The bonus to officers was contracted to be 20% of corporate net income before income taxes but the bonus contract did not specify whether the 20% was to be applied against income-before-deduction-of-bonus or against income-after-deduction-of-bonus.

**Required:**

(1) Prepare the condensed profit and loss statement which you, as auditor, would be willing to "certify." What is the audit fee?

(2) If this "certified" profit and loss statement and accompanying audit report were subsequently submitted to the First National Bank as the basis for a loan, what questions, if any, would you raise about this statement and report if, alternatively, you were the bank's officer in charge of commercial loans?

## Ultramares Corporation

The firm of Touche, Niven & Company, public accountants, had audited the year's accounts of Fred Stern & Company, rubber importers. Their "certified" balance sheet for the end of the year showed assets of $2,550,671.88, liabilities of $1,479,956.62, and capital stock and surplus of $1,070,715.26. In their certificate, the auditors stated:

> We have examined the accounts of Fred Stern & Co., Inc., for the year ending December 31, 19—, and hereby certify that the annexed balance sheet is in accordance therewith and with the information and explanations given us. We further certify that, subject to provision for federal taxes on income, the said statement, in our opinion, presents a true and correct view of the financial condition of Fred Stern & Co., Inc., as at December 31, 19—.

Shortly after receiving the "certified" balance sheet, Fred Stern & Company borrowed money from the Ultramares Corporation and submitted one of the balance sheets above prepared. Of $2,343,818.00 in loans all were paid except $250,237.40. A few months later, when Fred Stern & Company went into bankruptcy, the Ultramares Corporation filed suit against Touche, Niven & Company to recover on their unpaid loans. The corporation stated that the loans had been based on the balance sheet prepared by the auditing firm and, more importantly, that while the balance sheet showed an excess of assets over liabilities, the company was actually insolvent. The suits alleged negligence and fraud.

The evidence introduced at the trial[1] showed, among other things:

> . . . The total of the accounts receivable for December as posted by Seiss (a junior accountant) from the entries in the journal was $644,758.17. At some time on February 3, Romberg, an employee of the Stern Company . . . placed below that total another item to represent additional accounts receivable growing out of the transactions of the month. This new item, $706,843.07, Romberg entered in his own handwriting. The sales that it represented were, each, and all fictitious . . . Siess, when he resumed his work, saw the entries thus added, and included the new item in making up his footings, with the result of an apparent increase of over $700,000 in the assets of the business. He says that in doing this he supposed the entries to be correct, and that his task at the moment being merely to post the books, he thought the work of audit or verification might come later, and put it off accordingly. The time sheets . . . show very clearly that this was the order . . . in which the parts of the work were done. Verification, however, there never was either by Siess or by his superiors . . . .[2]

[1] *Ultramares Corporation* v. *Touche* (255 N.Y. 88, 174 N.E. 441).

[2] The auditors replied that "their audit was . . . a balance sheet audit, made as is customary by the testing and sampling method which tests and samples the accuracy of records by selecting a few items, the correctness of which, if established, results in the acceptance of such records as being accurate, this method not pretending to be exhaustive as a complete audit, the expense of which is often prohibitive. . . ."

The December entry of accounts receivable was not the only item that a careful and skillful auditor would have desired to investigate. There was ground for suspicion as to an item of $113,119.60, included in the accounts payable as due from the Baltic Corporation. As to this the defendants received an explanation, not very convincing, from Stern and Romberg. A cautious auditor might have been dissatisfied and have uncovered what was wrong.[3]

There was ground for suspicion also because of the inflation of the inventory. The inventory, as it was given to the auditors, was totaled at $347,219.08. The defendants discovered errors in the sum of $303,863.20, and adjusted the balance sheet accordingly. Both the extent of the discrepancy and its causes might have been found to cast discredit upon the business and the books.[4]

There was ground for suspicion again in the record of assigned accounts. Inquiry of the creditors gave notice to the defendants that the same accounts had been pledged to two, three and four banks at the same time. The pledges did not diminish the value of the assets, but made in such circumstances they might well evoke a doubt as to the solvency of a business where such conduct was permitted. There was an explanation by Romberg which the defendants accepted as sufficient. Caution and diligence might have pressed investigation further.[5]

At the conclusion of the trials, Judge Walsh stated that, as to negligence:

There must exist between the party inflicting the injury and the one injured some privity (connection) by contract or otherwise by reason of which the former owes some legal duty to the latter. Contractually, the defendants owed no duty to plaintiff because no such relationship existed between them, nor was there such privity

[3] The auditors replied that "they inquired of the officers of Stern & Co. and were informed that the United Baltic account showed an amount due from the creditor instead of an amount due to the creditor because the creditor had required Stern & Co. to deliver to it sterling credit in order to secure further purchases from the creditor by Stern & Co. . . ."

[4] The auditors replied that "there was nothing to indicate that the items in question were fictitious and that they received a certificate from the president and cashier of Stern & Co. to the effect that the inventory was correct and that all liabilities to creditors, banks or bankers, in respect to the inventory were shown on the books of the corporation."

[5] The auditors replied that "they had no reason to suspect the good faith of any of the officers of Stern & Co. and that the discrepancy observed in the assignments of accounts receivable was explained by the officers of Stern & Co. to their satisfaction; that the reports obtained from lending institutions were not complete, and that the defendants took for the purposes of their audit the greater amount shown by the day to day record of Stern & Co. rather than the smaller amount as indicated by the reports of the banks."

The auditors also stated "that the errors in the books and accounts of Stern & Co. which were found by them, were such as often found in auditing, without causing unfavorable comment or suspicion, and that such errors were corrected before the audit was completed."

between the plaintiff and defendants as to impose upon the latter a liability to the former for the negligence in performing their contract obligation with Stern & Co.

and Judge Cardozo stated:

. . . If there has been neither reckless misstatement nor insincere profession of an opinion, but only honest blunder, the ensuing liability for negligence is one that is bounded by the contract, and is to be enforced between the parties by whom the contract has been made.

As to fraud, Judge Cardozo stated:

Even an opinion, especially an opinion by an expert, may be found to be fraudulent if the grounds supporting it are so flimsy as to lead to the conclusion that there was no genuine belief back of it. . . .

Our holding does not emancipate accountants from the consequences of fraud. It does not relieve them if their audit has been so negligent as to justify a finding that they had no genuine belief in its adequacy, for this again is fraud. . . .

We conclude, to sum up the situation, that in certifying to the correspondence between balance sheet and accounts the defendants made a statement as true to their own knowledge, when they had, as a jury might find, no knowledge on the subject. . . .

Shortly after Judge Cardozo's opinion was announced, the case was settled out of court, the terms of settlement not being publicly disclosed.

**Required:**

(1) What are the auditor's responsibilities for negligence? Discuss.

(2) What are the auditor's responsibilities for fraud? Discuss.

(3) Are auditors responsible for the work done by those to whom the work of audit has been delegated?

(4) Should an auditor "certify" a balance sheet? Why?

(5) What does this case indicate as to the control which should be exercised over an audit engagement?

## Advertising

Following are actual examples of past advertising placed by accountants and lawyers. Examine these advertisements (and the code of accounting ethics, page 16). Should professional men advertise? Discuss.

# The Best of Business Building

Business men of today are building better than they know. Apparent enough are their great material advances in recent years, better products, improved processes, wider service, larger earnings. But far less visible, or appreciated even by themselves—because it is not *material*—is the constant building of their *mental* powers—development of a mind to vision clearly, think orderly, judge fairly, control firmly—a mind to see, to understand and so to be able to express something worth while materially.

Modern Accountancy points with pride to its inevitable service in the building of the *mind* of business. In the simple logic of its Budget, in its Detailed Audit, its orderly control of physical activities, its System in Management—it is a never-ending source of *mental* inspiration to the executive who is giving his life to put the *best he has into the building of a better business.*

**CALLAHAN & CO.**

**ACCOUNTANTS AND AUDITORS**

**SYSTEM SERVICE**

New York 17, N. Y.

## Rules of Professional Conduct

American Institute of Accountants

(These rules of conduct supplement the disciplinary clauses of the by-laws.)

(1) A firm or partnership, all the individual members of which are members of the Institute, may describe itself as "Members of the American Institute of Accountants," but a firm or partnership, not all the individual members of which are members of the Institute, or an individual practicing under a style denoting a partnership when in fact there be no partner or partners, or a corporation, or an individual or individuals practicing under a style denoting a corporate organization shall not use the designation "Members of the American Institute of Accountants."

(2) A member shall not allow any person to practice in his name who is not in partnership with him or in his employ.

(3) Commissions, brokerage or other participation in the fees or profits of professional work shall not be allowed directly or indirectly to the laity by a member.

Commissions, brokerage or other participation in the fees, charges or profits of work recommended or turned over to the laity as incident to services for clients shall not be accepted directly or indirectly by a member.

(4) A member shall not engage in any business or occupation conjointly with that of a public accountant, which is incompatible or inconsistent therewith.

(5) In expressing an opinion on representations in financial statements which he has examined, a member shall be held guilty of an act discreditable to the profession if:

(a) He fails to disclose a material fact known to him which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading; or

(b) He fails to report any material misstatement known to him to appear in the financial statement; or

(c) He is grossly negligent in the conduct of his examination or in making his report thereon; or

(d) He fails to acquire sufficient information to warrant expression of an opinion, or his exceptions are sufficiently material to negative the expression of an opinion: or

(e) He fails to direct attention to any material departure from generally accepted accounting principles or to disclose any material omission of generally accepted auditing procedure applicable in the circumstances.

(6) A member shall not sign a report purporting to express his opinion as the result of examination of financial statements unless they have been examined by him, a member or an employee of his firm, a member of the Institute, a member of a similar association in a foreign country, or a certified public accountant of a state or territory of the United States or the District of Columbia.

(7) A member shall not directly or indirectly solicit clients by circulars or advertisements, nor by personal communication or interview not warranted by existing personal relations, and he shall not encroach upon the practice of another public accountant. A member may furnish service to those who request it.

(8) Direct or indirect offer of employment shall not be made by a member to an employee of another public accountant without first informing such accountant. This rule shall not be construed so as to inhibit negotiations with anyone who of his own initiative or in response to public advertisement shall apply to a member for employment.

(9) Professional service shall not be rendered or offered for a fee which shall be contingent upon the findings or results of such service. This rule does not apply to cases involving federal, state or other taxes, in which the findings are those of the tax authorities and not those of the accountant. Fees to be fixed by courts or other public authorities, which are therefore of an indeterminate amount at the time when an engagement is undertaken, are not regarded as contingent fees within the meaning of this rule.

(10) A member shall not advertise his professional attainments or services:

(a) The publication of what is technically known as a card is restricted to an announcement of the name, title (member of American Institute of Accountants, CPA, or other professional affiliation or designation), class of service, and address of the person or firm, issued in connection with the announcement of change of address or personnel of firm, and shall not exceed two columns in width and three inches in depth if appearing in a newspaper, and not exceed one-quarter of a page if appearing in a magazine or similar publication.

(b) A paid listing in a directory is restricted to the name, title, class of service, address and telephone number of the person or firm and it shall not appear in bold type, box or other form of display or in a style which differentiates it from other listings in the same directory.

(11) A member shall not be an officer, director, stockholder, representative or agent of any corporation engaged in the practice of public accounting in any state or territory of the United States or the District of Columbia.

(12) A member shall not permit his name to be used in conjunction with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that the member vouches for the accuracy of the forecast.

(13) A member shall not express his opinion on financial statements of any enterprise financed in whole or in part by public distribution of securities, if he owns or is committed to acquire a financial interest in the enterprise which is substantial either in relation to its capital or to his own personal fortune, or if a member of his immediate family owns or is committed to acquire a substantial interest in the enterprise. A member shall not express his opinion on financial statements which are used as a basis of credit if he owns or is committed to acquire a financial interest in the enterprise which is substantial either in relation to its capital or to his own personal fortune, or if a member of his immediate family owns or is committed to acquire a substantial interest in the enterprise, unless in his report he discloses such interest.

(14) A member shall not make a competitive bid for professional engagements in any state, territory or the District of Columbia, if such a bid would constitute a violation of any rule of the recognized society of certified public accountants or the official board of accountancy in that state, territory, or district.

(15) A member of the American Institute of Accountants engaged in an occupation in which he renders services of a type commonly rendered by public accountants,

must observe the by-laws and rules of professional conduct of the Institute in the conduct of that occupation.

(16) A member shall not violate the confidential relationship between himself and his client.

**Required:**

(1) What is the purpose of having a code of professional ethics?

(2) State why you think each of the above rules is or is not desirable, from the standpoint of the accounting profession as well as society in general.

# 2. PRELIMINARY ARRANGEMENTS, WORKING PAPERS, ETC.

## Leslie Hardware Company

The Leslie Hardware Company was a wholesaler located in Portland, Oregon. The company had been organized in 1925 and had enjoyed a rather steady growth since that time. On December 31, 19— of the past calendar year, its net worth was slightly in excess of $1,000,000.00—consisting of capital stock ($100.00 par), $500,000.00 and the balance, earned surplus. The capital stock of the company was closely held; there were only 55 stockholders.

The company had never employed outside accountants. However, officers of the company recently decided to have an audit made of the company's accounts for the past calendar year just to see "if an audit would be of any benefit." You were invited to discuss arrangements with them and to make a bid on the job.

Following your return from a meeting with the company's treasurer, you dispatched the following letter:

January 20, 19—

Mr. William F. Carrigan, Treasurer
Leslie Hardware Company,
Portland, Oregon

Dear Mr. Carrigan:

Confirming our conversation of today, we shall be glad to make a "balance sheet audit" of the accounts of the Leslie Hardware Company as of December 31, 19—, this audit to include a test check review of your operations for the year ending that date.

In a first audit of this kind, a certain amount of extra work is involved such as verification and analysis of such accounts as beginning and ending inventories, fixed assets, capital stock and surplus, resulting in a fee which may be somewhat larger than that which may be expected for subsequent audits. We estimate that the first audit will take about 10 days and will cost about $2,500.00, based on the following per diem rates of compensation: principal, $50.00, senior accountant, $35.00, junior accountant, $20.00. As was brought out in our conversation, our work of audit will be considerably expedited by receipt of certain schedules prepared by your own accounting staff.

Four copies of our audit report will be furnished to you following the completion of our audit.

We believe that we can commence an audit of your accounts within a week or ten days following receipt of an authorization from you for the work.

Yours very truly,

______________________

**Required:**

(1) What is the purpose of the above letter? Is it complete? What are the schedules referred to in the second paragraph?

(2) Just what should be the substance of your conversation with Mr. Carrigan?

(3) In addition to the above letter, would you prepare any supplementary memorandum for your own office files? If so, what should be the content of such a memo? What would be the serviceabilities of the memorandum?

(4) What does the cost of an audit depend upon? Would you place a fixed price or bid on an audit? Why?

(5) If you later received a letter from Mr. Carrigan containing an "authorization of audit", would this letter be sufficient authority for you to perform the work of audit and to enforce collection of your audit bill?

## Bradley's Department Store, Inc.

Your firm is engaged in an audit of the accounts of Bradley's Department Store, Inc., for the past calendar year. At the beginning of your audit, you are requested by your senior-in-charge, to:

(1) Copy this and last year's trial balances on the working papers in ink; and to skip every other two lines.

(2) Show the increase or decrease of each item as compared with one year ago.

(3) Show the percentage of each expense to net sales of the proper year.

(4) Show the budgeted figures for the current year as, for example:

| | *Budgeted* | *Actual* |
|---|---|---|
| Legal Fees | $ 3,000.00 | $ 15,000.00 |
| Traveling Expenses | 70,000.00 | 64,000.00 |
| Advertising Expense: | | |
| *Agency* | | |
| Prentice & Cone | 80,000.00 | 150,000.00 |
| Rinehart & Hobbs | 120,000.00 | 55,000.00 |
| | $200,000.00 | $205,000.00 |

**Required:**

(1) What are the sources of information for the trial balances?

(2) Why does the senior-in-charge want this information? Should any of it be omitted?

(3) Should the working papers be sectionalized, i.e., one section for balance sheet accounts, one for profit and loss accounts?

(4) What should be the headings of the remaining columns of the master work sheet?

## Evans, Kennedy & Lee

Evans, Kennedy & Lee were certified public accountants with offices in San Francisco, California. Their payroll consisted of approximately 75 accountants and office employees, the field staff being somewhat larger during the months of January through April. To assist senior accountants in examining the system of internal check of clients, an Internal Check Questionnaire had been prepared by the firm covering such accounts and topics as cash, payrolls, accounts receivable, notes receivable, securities, and so on. The section on Cash for this questionnaire was as follows:

(1) Who is the cashier?__________
(2) To whom is the cashier responsible?__________
(3) Who keeps the cash receipts book?__________
(4) Who keeps the cash payments book?__________
(5) What are the duties of the cashier?__________
(6) To what ledgers does the cashier have access?__________
(7) Does the cashier ever prepare invoices?__________
(8) Does the cashier ever pass on credits?__________
(9) Does the cashier ever follow collections?__________
(10) Does the cashier ever authorize noncash credits to accounts receivable? __________
(11) When are collections deposited?__________By whom?__________
(12) Is any comparison made of collections and deposits, in total and in detail?__________
(13) How is cash received in the mails handled?__________
(14) How are cash sales of merchandise, fixed assets, and scrap handled?
__________
(15) How many signatures are required on checks?__________
(16) Who has authority to sign checks?__________
(17) Who gives this authority?__________
(18) Are checks numbered serially?__________
(19) Are checks ever signed "in blank"?__________
(20) Are checks audited properly prior to signature?__________
(21) Are checks ever made payable to Cash?__________
(22) Are supporting papers for disbursements so marked as to prevent their duplicate use at a later date?__________
(23) Who mails checks?__________
(24) How are spoiled checks handled?__________
(25) When is the bank balance reconciled?__________By whom?__________
(26) Are long outstanding checks investigated?__________
(27) When are the cash books closed?__________
(28) How long has the cashier held his present job?__________

(29) When was the last vacation of the cashier?____________________

(30) Is the cashier bonded?______________________________

**Required:**

(1) What is the purpose of a questionnaire like that above? Explain carefully.

(2) Is there one standard questionnaire which is applicable to all audit jobs? Discuss.

## Evans, Kennedy & Lee (*Continued*)

In addition to its Internal Check Questionnaire, the firm of Evans, Kennedy & Lee had also developed "audit programs" for its clients. These programs were intended to serve as guides to the company's senior accountants as they carried out their various audit engagements. The section on Petty Cash was as follows:

(1) Examine petty cash in the presence of petty cashier or other responsible person . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . ______
(2) Count and list coin, currency, checks . . . . . . . . . . . . . . . . . . ______
(3) Inspect and list vouchers on hand by name and account distribution . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . ______
(4) List all postdated checks, I.O.U.'s and other noncash items showing name, date, when due, amount . . . . . . . . . . . . . . ______
(5) Have all noncash items approved by responsible official . . . ______
(6) Verify subsequent convertibility of checks on hand into cash . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . ______
(7) Reconcile count of petty cash with balance of Petty Cash account. . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . ______
(8) Obtain signature of petty cashier acknowledging return of petty cash. . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . ______
(9) Obtain official cognizance in writing of any shortage or overage in the count of petty cash . . . . . . . . . . . . . . . . . . ______
(10) Test-check authenticity of petty cash vouchers for selected past dates . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . ______

As the various steps in the audit program were discharged, a $\checkmark$ mark was placed at the right side of the page.

**Required:**

(1) What is the purpose of an audit program like that above?

(2) Should all audits be based on written audit programs? Discuss.

(3) Is there one all-inclusive standard audit program which is applicable to all audit jobs? Discuss.

(4) Should the Audit Program and Internal Check Questionnaire be combined? Why?

## Ipswich Mills

In the case of *Ipswich Mills* v. *William Dillon* (260 Mass. 453), the plaintiff corporation demanded that their auditors surrender to them all work sheets, letters, and other papers, relevant to the company's affairs.

In its decision the court stated that:

. . . "work sheets" meant papers on which original compilations, computations and analyses are made by accountants, which later are gathered together in a summary form and the figures rendered in a schedule, exhibit, report or return upon which the accountant is working. . . . The work sheets were the defendants' property. They were made by them while engaged in their own business. . . . They were not employed to make these sheets. The sheets were merely the means by which the work for which the defendants were employed might be accomplished. The title to the work sheets remained in the defendants after the computations were made. . . . It has been held that plans prepared by an architect employed for that purpose belong to the one for whom they are made. But it has never been decided so far as we know that the preliminary plans and sketches of an architect belong to the person by whom the architect is employed. . . . On the record of the evidence disclosed in this case, the defendants were under no legal obligation to surrender their working sheets or other papers to the plaintiff.

**Required:**

(1) Do you agree with the court that title to working papers resides in the auditor? Why?

(2) In so far as the formal working papers of an audit engagement are concerned, draft a brief outline on "How to prepare and care for working papers"—this outline to be used as a general guide bv new junior accountants.

# 3. CASH

## Apex Company

On a balance sheet prepared by the bookkeeper of the Apex Company, the valuation of Cash was $42,714.89. Your analysis of cash revealed the details to be:

| | |
|---|---|
| Petty cash (including paid freight bills of $113.74) | $ 500.00 |
| Cash and currency in cash drawer | 3,469.17 |
| Stamps | 320.00 |
| I.O.U.'s of employees | 542.19 |
| Dishonored checks of customers | 3,807.11 |
| Bond coupons due but not yet presented for collection | 5,000.00 |
| Cash in bank | 26,076.42 |
| Cash funds advanced to salesmen to care for traveling expenses (15 salesmen at $200.00 each) | 3,000.00 |
| | $42,714.89 |

**Required:**

How would you verify the above items? At what value should Cash appear in the balance sheet? What adjusting entry or entries should be made on the working papers?

## Rollins & Ward, Inc.

As part of your balance sheet audit of Rollins & Ward, Inc., for the past calendar year, you examine the petty cash fund as of the close of business, December 31, 19—, 5:00 P.M. You find the contents of the fund to be:

Traveling expense vouchers, unnumbered, but all approved . . . . . . . . . . . . . . . . $231.46

Employee's I.O.U.'s:

J. B. Allen, $20.00; C. H. Bixler, $10.00; S. W. Dwyer, $10.00; R. J. Hallett, $15.00; W. J. Hughes, $10.00; J. E. Hurst, $10.00; M. E. Jenkins, $10.00; R. C. McGrath, $15.00; J. T. Smith, $10.00.

Currency:

$20.00 bills, 11; $10.00 bills, 26; $5.00 bills, 5; $1.00 bills, 31.

Coins:

Half-dollars, 11; quarters, 10; dimes, 12; nickels, 6; pennies, 34.

Postage stamps:

10¢ stamps, 48; 5¢ stamps, 60; 3¢ stamps, 2,442; 2¢ stamps, 1,374; 1¢ stamps, 127.

Cash sales tickets:

#3491 for $246.92; #3710 for $209.77; #4017 for $58.10; #4216 for $177.21.

Checks:

| *Dated* | *Maker* | |
|---|---|---|
| Dec. 10 | J. L. Bogard, assistant credit manager | $ 50.00 |
| 20 | C. M. Brent, employee | 25.00 |
| 19 | J. D. Brance & Co., customer | 58.10 |
| 16 | Garrison & Co., customer | 246.92 |
| 18 | Kelton & Ross, Inc., customer | 209.77 |
| Jan. 31 | Mary I. Lamson, employee, (postdated check) | 50.00 |
| Oct. 17 | Dan E. Morgan, former employee, present whereabouts not known | 20.00 |
| Dec. 15 | S. D. Tennant, office manager | 50.00 |

Except for the check of Dan E. Morgan, all checks were good as of check dates. The Morgan check, following its deposit on October 31, had been returned by the bank with the notation "no account."

The balance of the Petty Cash account on the ledger was $1,000.00; the fund was in charge of Mary I. Lamson, a lady of middle age. She was not under bond.

During your examination you ascertained that Miss Lamson often collected the proceeds on cash sales; and sometimes accepted cash from customers to apply on their accounts. Checks were usually turned over to the general cashier on the day of receipt; coin and currency were mingled with petty cash monies, adjustments for these collections being made whenever petty cash was reimbursed. Reimbursements occurred irregularly, usually two or three times a month, the last reimbursement being dated December 15. These practices occurred with the full knowledge of the general office staff and its management.

**Required:**

Prepare working papers covering your examination of petty cash.

## The Teleclox Company, Inc.

The balance of the Petty Cash account on the ledger of The Teleclox Company, Inc., on October 31, 19— was $600.00. The petty cash fund was in charge of Miss Virginia E. Anderson. The general cashier of the company was Mr. Herbert J. Treadwell, and the chief accountant, Mr. John C. Fleming. Your count of the petty cash fund, made on the morning following the close of the company's fiscal year, October 31, 19—, and in the presence of the petty cashier, showed the following inventory:

| Coin: | | Currency: | |
|---|---|---|---|
| 12 | $0.50 pieces | 2 | $20.00 bills |
| 18 | 0.25 " | 15 | 10.00 " |
| 15 | 0.10 " | 23 | 5.00 " |
| 23 | 0.05 " | 19 | 1.00 " |
| 52 | 0.01 " | | |

Checks:

| *Dated* | *Payee* | *Maker* | *Amount* |
|---|---|---|---|
| June 11 | Cash | V. E. Anderson | $ 5.00 |
| July 20 | " | " | 10.00 |
| Aug. 7 | " | " | 20.00 |
| Sept. 9 | " | " | 25.00 |
| Oct. 30 | " | " | 25.00 |
| 30 | " | Herbert J. Treadwell | 10.00 |
| 30 | The Teleclox Co., Inc. | King Salvage Company | 21.19 |
| | NOTE.—Attached to this check was a memo of the King Salvage Company showing their purchase of scrap materials. | | |
| 31 | Lee J. Forsythe | The Teleclox Co., Inc. | 45.00 |
| | NOTE.—This was a payroll check cashed by the petty cashier. | | |

Vouchers:

| *Dated* | *In Favor of* | *Description* | |
|---|---|---|---|
| Oct. 27 | Railway Express | "Collect" express on purchases | 6.19 |
| 29 | V. E. Anderson | Postage for October | 30.00 |
| 30 | James R. Corbett | Travel advance | 75.00 |
| 31 | V. E. Anderson | Carfare for October | 9.10 |

All checks and vouchers (which were unnumbered) were properly endorsed or approved. The company's daily bank deposits of general cash were taken to the bank by Miss Anderson who traveled by bus (single fare 10¢). It was also customary for all cash sales to be handled by the petty cashier. Miss Anderson stated that her five checks in the petty cash fund would be "cleared up within a month or sc."

**Required:**

Prepare working papers for the petty cash fund.

## Turodel Infirmary

Early in January the accounts of Turodel Infirmary were being audited for the calendar year 19— just closed. On January 2, 19—, the auditor's count of the petty cash fund of $1,000.00 disclosed the following items:

Currency:
Ten-dollar bills, 1; five-dollar bills, 15; one-dollar bills, 35.
Coin, in rolls, as received from bank:
Three rolls of quarters ($10.00 per roll); three rolls of dimes ($5.00 per roll); three rolls of nickels ($5.00 per roll); six rolls of pennies ($1.00 per roll).
Coins, loose:
Silver dollars, 10; half dollars, 19; quarters, 6; dimes, 13; nickels, 8; pennies, 67.
Currency and coins (in separate large envelope of heavy paper, marked "For Night Cashier"):
One-dollar bills, 6; quarters, 9; dimes, 8; nickels, 17; pennies, 10.

Checks:

| *Maker* | *Bank* | *Dated* | |
|---|---|---|---|
| D. P. Albert (account receivable) | First National Bank | Dec. 1, 19— | $ 60.04 |
| NOTE.—This check was cashed at the Central Trust & Deposit Company on December 5, 19—, then returned by this bank on December 6 with the notation "N.S.F." The check was still "N.S.F." on December 10, 19—. | | | |
| Jay C. Grayson | Lanier State Bank | Jan. 15, 19— | 100.00 |
| NOTE.—This transaction represented the cashing of a post-dated check for Mr. Grayson, assistant superintendent. | | | |
| Turodel Infirmary | National City Bank | Dec. 31, 19— | 102.10 |
| NOTE.—The payee of this check was F. C. Coleman, an employee. The check was properly endorsed when it was cashed by the petty cashier. | | | |

| | |
|---|---|
| U.S. Treasury bond, #H36782907, noncoupon, due 1969 | 100.00 |
| Postage stamps (in a separate container): | 10.00 |
| Vouchers covering: | |
| Cash register #1 (cash advanced to general lobby cashier) | 75.00 |
| Cash register #2 (cash advanced to coffee shop) | 50.00 |
| Cash register #3 (cash advanced to clinic) | 15.00 |
| Payments made for freight on incoming supplies | 11.69 |
| Payments made for general expense | 45.86 |
| Advance to John C. Lavelty, employee | 10.33 |
| Advance to Miss Helen B. Aintree, petty cashier | 15.00 |

MEMORANDUM.—There was a memorandum to the effect that there was a check outstanding for "reimbursement," $185.46. On investigation you find this to be a petty cash reimbursement request, dated December 31, 19—. You find, further, that check #10174 of December 31, 19—, for $185.46 has been drawn on general cash, in favor of the petty cashier although, at the moment of your examination, the check had not been signed.

**Required:**

(1) Working papers for petty cash.
(2) Auditor's adjusting entries, if any.

## Dorfmann Jobbing Company

On the general ledger of the Dorfmann Jobbing Company, two accounts for cash were carried, i.e., Cash, and Cash in Bank. The balance of the Cash account on December 31, 19—, was $1,000.00, this balance having remained unchanged throughout the year. This cash was in the office of the company and it was in charge of Mr. Rudolph D. Spendle. As a general rule all cash on hand over and above the minimum of $1,000.00 was deposited in the bank, the cash book entry being: Cash in Bank, dr., and Cash, cr.

On December 31, 19—, your count of cash on hand discloses the following:

| | |
|---|---|
| Coin | $ 68.13 |
| Currency, including one counterfeit bill for $20.00 and including, also, $89.00 in currency representing unrecorded cash sales made after 5:00 P.M. | 251.00 |
| N.S.F. check of a customer, Ben J. Levin, taken up from bank | 100.00 |
| I.O.U.'s of employees | 84.00 |
| Check of Will J. Dorfmann, president, cashed for him | 50.00 |
| Travel advance to John J. Leeds, salesman | 100.00 |
| Postage stamps on hand | 44.03 |
| Receipts for wages paid in cash to discharged employees | 119.40 |
| Unrecorded checks received from customers to apply on account | 215.09 |
| Vouchers for stationery and supplies | 38.16 |
| Vouchers for transportation bills on incoming merchandise | 27.19 |
| Voucher for C.O.D. purchase of merchandise | 374.68 |
| | $1,471.68 |

**Required:**

What is the correct balance for the Cash account? What adjusting entries are required?

## Wye Company*

In auditing the Wye Company, you obtain directly from the bank with which it does business, the bank statement, cancelled checks, and other memoranda which relate to the company's bank account for December, 19—. In reconciling the bank balance at December 31, 19—, with the balance for cash on the company's books you observe the facts set forth below:

| | | | |
|---|---|---|---|
| (1) | Balance per bank statement, December 31, 19—...... | | $88,489.12 |
| (2) | Balance per books, December 31, 19—.............. | | 58,983.46 |
| (3) | Outstanding checks, December 31, 19—............ | | 32,108.42 |
| (4) | Receipts of December 31, 19—, deposited January 2, 19—...................................... | | 5,317.20 |
| (5) | Service charge for November 19—, per bank memorandum of December 15, 19—.................. | | 3.85 |
| (6) | Proceeds of bank loan, December 15, 19—, discounted for 3 months at 5% per annum, omitted from company books.................................. | | 9,875.00 |
| (7) | Deposit of December 23, 19—, omitted from bank statement.................................. | | 2,892.41 |
| (8) | Check of Rome Products Company charged back by bank on December 22, 19—, for absence of countersignature and redeposited with complete signature on January 5, 19—, no entry on the books having been made for the charge-back or the redeposit......... | | 417.50 |
| (9) | Error on bank statement in entering deposit of December 16, 19—: | | |
| | Correct amount............................ | $3,182.40 | |
| | Entered in statement...................... | 3,181.40 | 1.00 |
| (10) | Check #3917 of Wyeth Manufacturing Company charged by bank in error to company's account..... | | 2,690.00 |
| (11) | Proceeds of note of J. Somers & Company, collected by bank on December 10, 19—, not entered in cash book: | | |
| | Principal.................................. | $2,000.00 | |
| | Interest................................... | 20.00 | |
| | | $2,020.00 | |
| | *Less* Collection charge...................... | 5.00 | 2,015.00 |
| (12) | Erroneous debit memorandum of December 23, 19—, to charge company's account with settlement of bank loan, which was paid by check #8714 on same date.. | | 5,000.00 |

(13) Error on bank statement in entering deposit of December 4, 19—:

| | | |
|---|---|---|
| Entered as | $4,817.10 | |
| Correct amount | 4,807.10 | 10.00 |

(14) Deposit of Wyeth Manufacturing Company of December 6, 19—, credited in error to this company.... 1,819.20

**Required:**

(1) Prepare a reconciliation of the Wye Company's bank account at December 31, 19—.

(2) Prepare the entries to adjust the Wye Company's books to reflect the correct cash balance at December 31, 19—.

## Bruce T. Reagan Company

This is your first audit of the Bruce T. Reagan Company for the year 19—. In your audit of the general cash account you are furnished with the bank reconciliation of December 31, 19— (one year ago), the cash receipts book, the cash payments book, and a correct summary of the bank statement for each of the twelve months of the current year under audit.

| | |
|---|---|
| Bank balance, December 31, 19— (one year ago) | $42,107.16 |
| *Less* Outstanding checks | 3,204.89 |
| | 38,902.27 |
| *Add* Undeposited cash of December 31, 19—, deposited Jan. 2, 19— | 3,104.21 |
| Cash, December 31, 19— | $42,006.48 |

| | *Cash Receipts* | *Cash Payments* | *Bank Statement Charges* | *Bank Statement Credits* |
|---|---|---|---|---|
| Balance | $ 42,006.48 | | | $ 42,107.16 |
| January | 32,104.16 | $ 33,874.19 | $ 35,108.19 | 35,208.37 |
| February | 49,816.20 | 42,016.21 | 43,646.10 | 49,816.20 |
| March | 34,646.19 | 30,001.88 | 29,617.40 | 31,821.77 |
| April | 41,816.77 | 36,121.19 | 37,004.12 | 44,641.19 |
| May | 61,004.91 | 42,667.10 | 38,987.69 | 58,236.11 |
| June | 38,194.16 | 30,279.86 | 32,616.80 | 39,118.26 |
| July | 22,188.65 | 22,505.90 | 23,199.19 | 24,033.35 |
| August | 18,083.42 | 20,689.41 | 21,001.07 | 18,083.42 |
| September | 26,110.84 | 25,813.72 | 23,716.26 | 25,871.15 |
| October | 39,265.77 | 31,681.54 | 30,009.61 | 36,756.85 |
| November | 44,740.06 | 32,071.29 | 33,216.75 | 38,141.01 |
| December | 52,119.43 | 32,116.09 | 32,201.64 | 50,266.93 |
| Balance | | 112,258.66 | 113,776.95 | |
| | $496,097.04 | $496,097.04 | $494,101.77 | $494,101.77 |
| Balance | $112,258.66 | | | $113,776.95 |

As of December 31, 19— (current year), the total of outstanding checks is $6,718.45, and the recorded but undeposited cash is $5,200.16.

**Required:**

Prepare your working papers showing cash, bank reconciliation, and all relevant information relating to the examination of cash.

# The Bardeen Corporation

## Reconciliation of Cash

On January 31, 19—, the bank reconciliation of The Bardeen Corporation was as follows:

| | | |
|---|---|---|
| Bank balance, January 31, 19— | | \$34,064.65 |
| *Less* Outstanding checks: | | |
| \$11.25 + 173.45 + \$100.00 + \$7.50 | = | 292.20 |
| Cash account balance, January 31, 19— | | \$33,772.45 |

The cash books for the month of February, and the bank statement as of February 28, 19—, are reproduced on page 35.

The bank charge of \$10,100.00 on February 21, 19— was a debit memorandum by the bank covering the cost of \$10,000.00 par value 3% International Steel Company bonds of 1960, including accrued interest of \$100.00. The charge of \$10.63 on February 28 covered sundry bank service charges for the month—exchange on checks, activity charge, etc. The debit of \$436.21 on the same date was for a check deposited by The Bardeen Corporation on February 26 but returned by the bank marked "no account." The maker of the check was Henry J. Berger, a new customer.

**Required:**

(1) Prepare working papers showing the reconciliation of Cash as of February 28, 19—. Adjusting entries, if required, should be clearly indicated.

**Cash Book**

| | Cash Receipts | | Cash Payments |
|---|---|---|---|
| Feb. 1 | 532.87 | 2 | 3,521.25 |
| 2 | 316.41 | | 9.00 |
| 3 | 646.90 | | 100.00 |
| 4 | 379.86 | 3 | 15.62 |
| | 901.87 | | 100.00 |
| 5 | 1,874.33 | | 352.86 |
| 6 | 879.43 | 4 | 711.21 |
| 7 | 437.01 | | 812.27 |
| 8 | 2,064.06 | | 8.06 |
| 9 | 1,119.39 | 5 | 1,830.61 |
| 10 | 549.21 | | 707.50 |
| 11 | 437.89 | 6 | 8.00 |
| | | | 250.04 |
| 12 | 1,001.55 | 7 | 306.19 |
| 13 | 869.32 | 8 | 2,250.74 |
| 14 | 884.31 | | 11.16 |
| 15 | 2,010.75 | 9 | 110.00 |
| | 514.99 | | 7.50 |
| | 367.85 | 10 | 107.99 |
| 17 | 1,091.14 | | 609.77 |
| | 3,025.66 | | 100.01 |
| | 14.50 | | |
| | 668.99 | 12 | 250.16 |
| | 829.39 | 13 | 1,000.00 |
| 18 | 1,012.31 | 14 | 2,305.72 |
| | 844.86 | 15 | 3.75 |
| 19 | 901.01 | | 418.45 |
| | 1,704.68 | 17 | 2,155.40 |
| 20 | 1,014.99 | | 48.20 |
| | 1,018.33 | 18 | 10.00 |
| 21 | 127.13 | 19 | 1.04 |
| | 578.77 | | 878.14 |
| 22 | 23.66 | 20 | 12.39 |
| 24 | 147.44 | 21 | 6,100.07 |
| | 361.42 | 22 | 100.00 |
| 25 | 2,035.34 | 24 | 100.00 |
| | 1,076.43 | 25 | 107.68 |
| | 3,067.45 | | 784.19 |
| | 2,064.01 | | 1,807.60 |
| | 868.77 | | 28,012.57 |
| | 1,041.35 | | |
| | 436.21 | | |
| | 241.14 | | |
| 26 | 634.35 | | |
| | 429.21 | | |
| | 210.10 | | |
| | 400.00 | | |
| | 2,543.05 | | |
| | 451.59 | | |
| | 1,682.06 | | |
| | 384.87 | | |
| | 201.62 | | |
| | 46,919.83 | | |

**Bank Statement**

| | Charges | | Deposits | Balance |
|---|---|---|---|---|
| Feb. 1 | | | | 34,064.65 |
| 3 | 11.25 | | | 34,053.40 |
| 4 | 3,521.25 | 8.06 | | 30,524.09 |
| 5 | | | 1,496.18 | 32,020.27 |
| 6 | 250.04 | 100.00 | | 31,670.23 |
| 7 | 100.00 | 15.62 | | 31,554.61 |
| 8 | 9.00 | 812.27 | | 30,733.34 |
| 10 | 7.50 | | | 30,725.84 |
| | | | 7,655.95 | 38,381.79 |
| 11 | 11.16 | | | 38,370.63 |
| 12 | 110.00 | 1,830.61 | | 36,430.02 |
| 13 | 352.86 | | | 36,077.16 |
| 14 | 100.01 | 1,000.00 | | |
| | 8.00 | 707.50 | | 34,261.65 |
| | | | 3,742.28 | 38,003.93 |
| 17 | 7.50 | | | |
| | 2,155.40 | | | 35,841.03 |
| | | | 8,523.27 | 44,364.30 |
| 18 | 107.99 | 306.19 | | 43,950.12 |
| 19 | 173.45 | 48.20 | | 43,728.47 |
| 20 | 2,305.72 | | | 41,422.75 |
| | | | 6,496.18 | 47,918.93 |
| 21 | 10,100.00 | 250.16 | | |
| | 609.77 | 12.39 | | 36,946.61 |
| 22 | 3.75 | 878.14 | | 36,064.72 |
| 24 | 6,100.07 | 10.00 | | 29,954.65 |
| | | | 1,238.42 | 31,193.07 |
| 25 | 711.21 | 1.04 | | |
| | 100.00 | | | 30,380.82 |
| | | | 10,830.70 | 41,211.52 |
| 26 | 100.00 | | | 41,111.52 |
| | | | 4,668.30 | 45,779.82 |
| 27 | 100.00 | 2,250.74 | | |
| | 418.45 | | | 43,010.63 |
| 28 | 10.63 | | | 43,000.00 |
| | 436.21 | | | 42,563.79 |

## Knox, Trilling & Company

You are preparing a reconciliation of the cash account, December 31, 19—, in connection with your audit of the accounts of Knox, Trilling & Company for the past calendar year. The following information is available for this purpose:

*Bank reconciliation, November 30, 19—, prepared by the company's bookkeeper and cashier, Victor T. Colway:*

| | | | | | |
|---|---|---|---|---|---|
| Bank balance, November 30, 19— | | | | | $13,409.76 |
| *Add* Cash deposited November 30, credited December 1 | | | | | 1,029.11 |
| Collection and exchange charges | | | | | 7.32 |
| | | | | | $14,446.19 |
| *Less* Outstanding checks: | | | | | |
| # 109 | $100.00 | #1127 | | $ 264.31 | |
| 1121 | 132.47 | 1128 | | 40.00 | |
| 1125 | 201.19 | 1129 | | 147.40 | |
| | | 1131 | | 13.50 | |
| | | | | $ 898.87 | |
| Collection by bank on November 28, of sight draft drawn on R. S. DeLoitte, a customer | | | | 1,000.00 | |
| Check #1099 recorded as | | | $361.74[1] | | |
| should have been recorded as | | | 316.74 | 45.00 | 1,943.87 |
| Cash, balance per general ledger, November 30, 19— | | | | | $12,502.32 |

[1] Debited to Utilities Expense.

The condensed cash receipts book, cash payments book, and bank statement for the month of December, 19—, were as follows:

**Cash Book**

| | | *Cash Receipts* | *Check No.* | *Cash Payments* |
|---|---|---|---|---|
| Dec. 1 | Balance | 12,502.32 | | |
| 2 | ....... | 732.19 | #1132.. | 1,931.62 |
| 3 | ....... | 1,216.04 | 3.. | 1,721.71 |
| 5 | ....... | 387.22 | 4.. | 1,326.09 |
| 6 | ....... | 100.00 | 5.. | 2,014.77 |
| 8 | ....... | 2,674.31 | 6.. | 1,381.22 |
| 9 | ....... | 1,327.16 | 7.. | 1,987.16 |
| 10 | ....... | 1,276.47 | 8.. | 1,499.75 |
| | ....... | 2,306.67 | 9.. | 1,500.00 |
| | ....... | 3,422.74 | | |
| 12 | ....... | | 1140.. | 732.69 |
| 14 | ....... | 2,074.06 | 1.. | 1,526.10 |
| 15 | ....... | 890.09 | 2.. | 1,801.11 |
| 17 | ....... | 1,009.66 | 3.. | 1,237.63 |
| 20 | | | 4.. | 902.67 |
| 21 | ....... | 2,146.70 | | |
| 22 | | | 5.. | 1,626.88 |
| 23 | ....... | 5,174.19 | 6.. | 1,899.40 |
| 26 | ....... | 2,683.16 | 7.. | 1,262.56 |
| 27 | ....... | 1,000.00 | 8.. | 503.16 |
| | | | 9.. | 1,426.34 |
| 28 | ....... | 1,016.11 | 1150.. | 891.72 |
| 29 | | | 1.. | 502.99 |
| 30 | | | 2.. | 1,216.21 |
| 31 | ....... | 238.76 | 3.. | 301.42 |
| | | | 4.. | 420.24 |
| | Balance | | | 12,564.41 |
| | | 42,177.85 | | 42,177.85 |
| Jan. 1 | Balance | 12,564.41 | | |

**Bank Statement**

| | | *Charges* | *Credits* |
|---|---|---|---|
| Dec. 1 | Balance | | 13,409.76 |
| 1 | ....... | 147.40 | 1,029.11 |
| 2 | ....... | 201.19 | |
| 3 | ....... | 13.50 | |
| 5 | ....... | 1,931.62 | 2,335.45 |
| | ....... | 264.31 | |
| 6 | ....... | 1,326.09 | |
| 7 | ....... | 132.47 | 4,950.00[1] |
| 9 | ....... | 2,014.77 | |
| 10 | ....... | 1,381.22 | 4,001.47 |
| 12 | ....... | 732.69 | |
| | ....... | 1,987.16 | |
| 13 | ....... | 2.16[2] | |
| 14 | ....... | 1,500.00 | 7,105.88 |
| 15 | ....... | | 2,074.06 |
| 16 | ....... | 1,499.75 | |
| 19 | ....... | 1,801.11 | 1,899.75 |
| 21 | ....... | 1,721.71 | |
| 22 | ....... | 1,237.63 | 2,146.70 |
| 23 | ....... | 40.00 | |
| 26 | ....... | 1,626.88 | 996.00[3] |
| 28 | ....... | 1,526.10 | |
| | ....... | 1,262.56 | |
| 29 | ....... | 902.67 | 8,857.35 |
| 30 | ....... | 502.99 | 1,016.11 |
| | ....... | 891.72 | |
| 31 | ....... | 1,000.00[4] | |
| | ....... | 1,426.34 | |
| | | 27,074.04 | 49,821.64 |
| Jan. 1 | Balance | | 22,747.60 |

[1] Proceeds on a 60-day bank loan, $5,000.00 note, less 6% bank discount.

[2] Charges for collection and exchange.

[3] Collection of sight draft drawn on Duane D. Collins, a customer, $1,000.00 less bank service charge of $4.00.

[4] Check of Max J. Stein, a customer, returned by bank with notation "N.S.F."

**Required:**

Prepare working papers showing reconciliation of cash. All items on the bank statement are correct.

## Harry E. Wills

In your examination of the cash of Mr. Harry E. Wills on December 31, 19—, you find that the last reconciliation of cash was dated August 31, 19—. It was as follows:

| | |
|---|---|
| Bank balance, August, 31, 19— | $3,920.95 |
| *Less* Outstanding checks: | |
| $4.00 + 15.50 + 200.00 | 219.50 |
| Cash, per books, August 31, 19— | $3,701.45 |

In condensed form the cash book and bank statement of Mr. Wills for the period September 1 – December 31, 19—, were as follows:

| | Cash Book | | Bank Statement | | |
|---|---|---|---|---|---|
| | *Receipts* | *Payments* | *Checks* | *Deposits* | *Balance* |
| Aug. 31 | | | | | 3,920.95 |
| Sept. 1 | 131.66 | 250.00 | 200.00 | | 3,720.95 |
| 2 | | | 250.00 | | 3,470.95 |
| 3 | | 200.00 | 200.00 | | 3,270.95 |
| 4 | 246.12 | | 4.00 | | 3,266.95 |
| 9 | 16.99 | | 15.50 | | 3,251.45 |
| 10 | | 100.00 | 100.00 | | 3,151.45 |
| | | 100.00 | | | |
| 16 | 309.37 | | 100.00 | | 3,051.45 |
| 18 | | 18.00 | | | |
| 20 | | 2.50 | | | |
| | | 11.00 | | | |
| 23 | | | 11.00 | | 3,040.45 |
| 24 | 308.44 | | 18.00 | | 3,022.45 |
| 25 | | 5.00 | 2.50 | | 3,019.95 |
| 29 | | 1,750.00 | | | |
| 30 | | | 1,700.00 | 1,012.58 | 2,332.53 |
| Oct. 7 | 11.55 | 2.69 | | | |
| 10 | 38.48 | 10.00 | | | |
| | | 100.00 | | | |
| 11 | 101.23 | 39.62 | | | |
| 14 | 344.15 | | 39.62 | | 2,292.91 |
| 17 | 77.77 | 25.00 | | | |
| 20 | 500.00 | | 2.69 | | 2,290.22 |
| 21 | 235.35 | | 5.00 | | 2,285.22 |
| 22 | 410.47 | | 25.00 | | 2,260.22 |
| 29 | 100.01 | | 100.00 | | 2,160.22 |
| 31 | 512.35 | 250.00 | | | |
| Nov. 1 | 154.52 | 4.80 | | | |
| 3 | | 100.00 | 100.00 | 573.18 | 2,633.40 |
| 6 | | 3.75 | | 1,912.70 | 4,546.10 |
| 7 | 414.44 | | 4.80 | | 4,541.30 |
| 10 | | 1,416.30 | 250.00 | | 4,291.30 |
| | | 100.00 | | | |
| 11 | 57.00 | 4.50 | | | |
| 14 | | | 1,416.30 | | 2,875.00 |
| 18 | | 20.60 | | | |
| 20 | 100.00 | 3.00 | | | |
| 21 | | 100.00 | 4.50 | | |
| | | | 100.00 | | 2,770.50 |
| 24 | | | 100.00 | | |
| | | | 3.75 | | 2,666.75 |

| | Cash Book (*Cont.*) | | Bank Statement (*Cont.*) | | |
|---|---|---|---|---|---|
| | *Receipts* | *Payments* | *Checks* | *Deposits* | *Balance* |
| 25 | | | 10.00 | | |
| | | | 20.60 | | 2,636.15 |
| 26 | 114.14 | 4.70 | | | |
| 28 | | 101.49 | | | |
| Dec. 1 | | 7.50 | 100.00 | 685.58 | 3,221.73 |
| | | 100.00 | | | |
| 3 | 101.00 | | 101.49 | | |
| | | | 3.00 | | 3,117.24 |
| 5 | 36.50 | | 7.50 | | 3,109.74 |
| 10 | 84.21 | 100.00 | 4.70 | | 3,105.04 |
| 11 | | 11.00 | | | |
| 18 | 115.72 | | 11.00 | | 3,094.04 |
| 20 | 100.07 | 15.00 | | | |
| 22 | 11.00 | | 100.00 | | 2,994.04 |
| 23 | 19.89 | 22.25 | | 437.50 | 3,431.54 |
| 24 | 112.34 | 302.25 | 210.71 | | |
| | 61.27 | 210.71 | 302.25 | | |
| | | 225.00 | 225.00 | 204.50 | 2,898.08 |
| | | 185.25 | | | |
| 26 | 131.16 | 1,266.30 | | | |
| 30 | 277.22 | | 100.00 | | 2,798.08 |
| 31 | | | 1,266.30 | | 1,531.78 |
| | | | | 2,500.00 | 4,031.78 |
| | 5,234.42 | 7,168.21 | | | |

The cancelled check of $1,700.00 appearing in the bank statement is found, on examination, to be Mr. Wills' check of September 29 wrongly recorded in the cash payments book as $1,750.00. Mr. Wills stated that, originally, a check for $1,750.00 had been written as a down payment on an accounts payable invoice but that this check had been torn up and a new one for $1,700.00 written in its place.

The cancelled check for $100.00 (December 22) is found to be Mr. Wills' check of the same date issued in favor of "Cash." This was a counter check drawn by Mr. Wills at the bank in order to procure some cash for his immediate personal use.

The $2,500.00 credit item on the bank statement (December 31) represents the proceeds of a bank loan procured on that date. The loan was in the form of a 6% note for $2,500.00, due for payment on March 31, 19—.

**Required:**

(1) Reconciliation of the bank account, December 31, 19—.

(2) What adjusting entries and corrections should be placed on the books?

## Lincoln Sales Company

Franklin & Graham, certified public accountants, were engaged in a balance sheet audit of the Lincoln Sales Company as of December 31, 19—. In their examination of cash, the auditors were given bank reconciliations by Mr. John A. Ward, cashier, as follows:

| | | |
|---|---|---|
| Nov. 30 Bank balance.... | | $16,676.00 |
| *Add* Unrecorded cash...... | | 200.00 |
| | | $16,876.00 |
| *Less* Outstanding checks: | | |
| #674 (July 7) | $201.00 | |
| 980........ | 964.00 | |
| 994........ | 314.00 | |
| 996........ | 245.00 | |
| 999........ | 688.00 | 2,412.00 |
| Nov. 30 Cash balance.... | | $14,464.00 |

| | | |
|---|---|---|
| Dec. 31 Bank balance.. | | $12,266.00 |
| *Add* Unrecorded cash.... | | 212.00 |
| N.S.F. check........ | | 1,017.00 |
| Bank service charge | | 10.00 |
| | | $13,505.00 |
| *Less* Outstanding checks: | | |
| # 674..... | $201.00 | |
| 1003..... | 84.00 | |
| 1011..... | 12.00 | |
| 1019..... | 412.00 | |
| 1021..... | 522.00 | |
| 1023..... | 501.00 | |
| 1025..... | 141.00 | |
| 1026..... | 239.00 | |
| 1028..... | 762.00 | |
| 1029..... | 804.00 | 3,678.00 |
| Dec. 31 Cash balance.. | | $ 9,827.00 |

The cash books and bank statement, condensed, were as follows:

CASH RECEIPTS BOOK

| | | |
|---|---|---|
| Dec. 1 | Balance | 14,464.00 |
| 1 | | 326.00 |
| 2 | | 218.00 |
| 5 | (Cash sale) | 304.00 |
| 6 | | 516.00 |
| 8 | | 1,870.00 |
| 12 | | 751.00 |
| 15 | | 616.00 |
| 16 | | 1,211.00 |
| 18 | | 807.00 |
| 20 | (Cash sale) | 104.00 |
| 22 | | 219.00 |
| 25 | | 813.00 |
| 28 | | 1,017.00 |
| 30 | | 628.00 |
| 31 | (Cash sale) | 212.00 |
| | | 23,876.00 |
| Jan. 1 | Balance | 9,827.00 |

CASH PAYMENTS BOOK

| | |
|---|---|
| Check #1000 | 1,310.00 |
| 1001 | 70.00 |
| 1002 | 411.00 |
| 1003 | 84.00 |
| 1004 | 104.00 |
| 1005 | 81.00 |
| 1006 | 76.00 |
| 1007 | 111.00 |
| 1008 | 62.00 |
| 1009 | 39.00 |
| 1010 | 86.00 |
| 1011 | 12.00 |
| 1012 | 128.00 |
| 1013 | 740.00 |
| 1014 | 122.00 |
| 1015 | 806.00 |
| 1016 | 2,084.00 |
| 1017 | 610.00 |
| 1018 | 300.00 |
| 1019 | 412.00 |
| 1020 | 864.00 |
| 1021 | 522.00 |
| 1022 | 409.00 |
| 1023 | 501.00 |
| 1024 | 672.00 |
| 1025 | 141.00 |
| 1026 | 239.00 |
| 1027 | 487.00 |
| 1028 | 762.00 |
| 1029 | 804.00 |
| Balance | 9,827.00 |
| | 23,876.00 |

BANK STATEMENT

Dec. 1 Balance .................................16,676.00

| | Charges | Deposits |
|---|---|---|
| 2 | 70.00 | 326.00 |
| 3 | 688.00 | 218.00 |
| | 1,310.00 | |
| 5 | 76.00 | |
| | 314.00 | |
| 6 | 411.00 | |
| 7 | 62.00 | |
| 8 | 81.00 | 516.00 |
| 9 | 39.00 | |
| 10 | 500.00 | |
| 12 | 104.00 | |
| 15 | 86.00 | |
| 17 | 964.00 | |
| 19 | 111.00 | |
| 20 | | 616.00 |
| 21 | 3,084.00 | 1,211.00 |
| 22 | 128.00 | 807.00 |
| | 122.00 | |
| 23 | 300.00 | 500.00[1] |
| 24 | 806.00 | |
| 26 | 245.00 | 219.00 |
| | 740.00 | |
| 27 | 864.00 | 2,621.00 |
| 28 | 672.00 | 813.00 |
| | 610.00 | |
| 29 | 409.00 | 1,017.00 |
| | 487.00 | |
| 30 | 1,017.00[2] | 1,036.00 |
| | 10.00[3] | |

31 Balance .................................12,266.00

[1] Cash received from employees for U.S. Savings Bonds.
[2] Check of S. J. Greene, a customer, charged back N.S.F.
[3] Charge of bank for printing checks.

The bank balance of $12,266.00 was independently confirmed to the auditors by the bank.

Cash on hand in the office of the Lincoln Sales Company on December 31, 19—, was coin and currency, $100.00 and one customer's check, $112.00.

The deposit on December 30, consisted of one check, $628.00, and coin and currency, $408.00.

Checks of the Lincoln Sales Company required one signature, that of the president, the vice-president, or the cashier. As a general rule checks were signed by the cashier. None of these individuals was under bond.

Check #1016 for $2,084.00 in the cash payments book, a bonus payment to E. A. Corwin (salesman), was recorded in the bank statement as $3,084.00.

In contrast to other checks of the Lincoln Sales Company, whose serial numbers were printed and whose amounts were written by a check-writing machine, check #1016 was written in pen and ink, including serial number. It was endorsed by E. A. Corwin and J. A. Ward. From other office information made available to the auditors, it appeared that the correct amount of bonus due Mr. Corwin was $2,084.00.

**Required:**

You are required to audit cash and to present a summary of your findings and adjustment entries, if any, on auditor's working papers. What amount of cash should appear on the balance sheet of December 31, 19—?

## J. Philip Hurwitz

On February 1 of this year you commenced your audit of last year's accounts of J. Philip Hurwitz, who operates a salvage and scrap metals business. In establishing the value for cash as of December 31, 19—, you find that the cash records of the year have been kept so poorly as to be generally unserviceable to you. For the month of January of the current year the cash records have been kept reasonably well. However, the bookkeeper informs you that bank deposits were made irregularly of all available cash on hand at date of deposit; and that Mr. Hurwitz sometimes took coin or currency from the cash drawer for his personal use without leaving any "paid out" memoranda. There was no suggestion that any disbursements were ever unauthorized.

Your count of coin, currency, and checks at the beginning of business, February 1, 19—, totaled $8,000.00. The summarized cash books and bank statement for the month of January follow:

| | *Cash Receipts Book* | Cash Payments Book *Check No.* | *"Paid Out" Cash Memo* | *Amount* |
|---|---|---|---|---|
| Jan. 1 | 100.00 | 1 | | 87.13 |
| 2 | 800.00 | 2 | | 150.00 |
| 5 | | 3 | | 45.00 |
| 8 | | 4 | | 105.00 |
| 9 | 600.00 | | #1 | 10.50 |
| 10 | | | 2 | 9.20 |
| 12 | 4,000.00 | 5 | | 12.17 |
| 13 | 400.00 | 6 | | 400.00 |
| 15 | 350.00 | | 3 | 80.30 |
| 17 | | 7 | | 415.00 |
| 20 | | 8 | | 100.50 |
| 21 | 1,150.00 | 9 | | 5,429.50 |
| | | | 4 | 10.00 |
| 23 | 600.00 | | | |
| 24 | 700.00 | 10 | | 700.00 |
| 26 | | | 5 | 67.50 |
| 27 | 7,000.00 | | 6 | 32.50 |
| 28 | | | 7 | 25.20 |
| 30 | 400.00 | 11 | | 570.50 |
| 31 | 200.00 | 12 | | 300.00 |
| | 16,300.00 | | | 8,550.00 |

Bank Statement

| | Charges | Deposits | Balance |
|---|---|---|---|
| | | | 2,711.62 |
| Jan. 1 | 1,000.00 | | |
| | 14.74 | | |
| | 670.00 | | 1,026.88 |
| 2 | 87.13 | | 939.75 |
| 3 | 500.00 | | |
| | 317.00 | | |
| | 22.50 | | 100.25 |
| | | 950.00 | 1,050.25 |
| 9 | 45.00 | | 1,005.25 |
| | | 1,000.00 | 2,005.25 |
| 14 | 105.00 | | |
| | 400.00 | | 1,500.25 |
| 16 | | 4,850.00 | 6,350.25 |
| 22 | 100.50 | | |
| | 5,429.50 | | 820.25 |
| 23 | | 1,000.00 | 1,820.25 |
| 26 | 700.00 | | 1,120.25 |
| 27 | 12.17 | | 1,108.08 |
| 28 | | 600.00 | 1,708.08 |
| 29 | 150.00 | | 1,558.08 |

**Required:**

Prepare audit working papers to show the balance of cash on the balance sheet of December 31, 19—. None of the cash collections of December were included in the bank deposits of January; none of the collections of January 26–31 had been deposited. On February 1, 19—, as far as can be ascertained, there were no outstanding checks from December or earlier months.

## Holmes Manufacturing Company

The general cash account of the Holmes Manufacturing Company was being audited as of December 31, 19—. In the course of their examination, the auditors found a monthly check for $1,000.00 made out to D. H. Holmes, president, and charged to Private Ledger. On the private ledger the debit was to General Expense. It was discovered, however, that the proceeds of these special checks had been deposited in a checking account in a bank with which the company did not normally do business. The account was carried in the name of D. H. Holmes.

In support of this special bank account, a separate cash receipts and payments book was maintained. The auditors examined all receipts and disbursements and found adequate supporting vouchers for each item of cash. The cash balance was verified with the bank statement and by independent bank confirmation of the balance on deposit December 31, 19—. After these reconciliations had been completed, the net balance of this special cash fund was determined to be $5,014.23.

Mr. Holmes explained that this fund was really company cash which was handled by him personally. He stated that the fund was used for purposes which he preferred not to have reflected in the regular accounts of the business. He stated that disbursements were made for such purposes as private police, private detective service, "fees, commissions, and bonuses" paid to procure and maintain contracts, and other legal similar purposes. The existence of the fund was known only to himself and five directors of the company. Because of the nature of the fund, the president requested that it be not included in the balance sheet. General cash of the company amounted to $144,018.67.

**Required:**

What should be the position of the audtitors? Should the fund be omitted from the balance sheet? Should it be included in the working papers? Discuss.

## James T. Eddy & Company

At the close of the past calendar year, James T. Eddy & Company was interested in having the balance sheet of the company show as strong a liquid position as possible. The bookkeeper's tentative balance sheet for the end of the year showed current assets and liabilities as follows:

| | | | |
|---|---|---|---|
| Current Assets: | | Current Liabilities: | |
| Cash | $ 50,169.58 | Accounts Payable | $52,018.42 |
| Accounts Receivable | 14,095.98 | Wages, Taxes and Interest Payable | 7,969.96 |
| Merchandise | 26,171.31 | | |
| Marketable Securities (cost) | 19,597.80 | | |
| | $110,034.67 | | $59,988.38 |

After he had examined these figures, the president of the company, Mr. James T. Eddy, decided that it would be possible to show a much stronger current position. He directed the elimination of merchandise and accounts payable of $1,804.08 which amount represented an order of rubber packing and miscellaneous supplies from the Seiberlock Packing Company. The merchandise represented by this order was not actually on hand nor had an invoice been received to cover it. Nevertheless the bill of lading was on hand and proved that the shipment was in transit.

Mr. Eddy then directed his cashier to prepare checks in payment of $42,824.01 of the accounts payable, and told the bookkeeper to adjust the balance sheet of December 31, 19—, so as to reflect the new status of financial condition.

The checks, properly prepared and signed, were not immediately dispatched. Mr. Eddy instructed the cashier to hold them in the office vault until their placement in the mails was authorized. The checks were actually mailed on January 10th.

**Required:**

As an independent accountant, how would you present the company's current position as of December 31, 19—? Discuss fully.

## E. J. Bates Company

On December 31, 19—, the condensed trial balance of the E. J. Bates Company was as follows:

| | | |
|---|---|---|
| Cash | $150,000.00 | |
| Accounts Receivable | 288,000.00 | |
| Inventory | 225,000.00 | |
| Prepaid Expenses | 7,000.00 | |
| Buildings | 160,000.00 | |
| Land | 20,000.00 | |
| Accounts Payable | | $ 50,000.00 |
| Common Stock, $100.00 par | | 500,000.00 |
| Earned Surplus | | 300,000.00 |
| | $850,000.00 | $850,000.00 |

In an audit of the company's accounts, it was discovered that the amount of cash on hand should have been $200,000.00. The shortage in cash had been concealed by clever bookkeeping and by overstating the value of the ending inventory by $50,000.00. Upon being faced with proof of the shortage and consequences thereof, the offer of the treasurer (Mr. J. L. Dudley) to make restitution was accepted as follows: (1) He was to resign from the company. (2) All of the company's capital stock owned by the treasurer—500 shares—was to be turned over to the corporation at a price equal to the book value of the capital stock presently outstanding, less 10%. (3) Any balance remaining to the credit of the treasurer was to be instantly payable to him in cash.

Immediately after this settlement had been consummated, directors of the company distributed the 500 shares of stock as a special dividend to stockholders.

**Required:**

(1) Entries to record the above transactions.

(2) Balance sheet, after giving effect to the special dividend.

# 4. ACCOUNTS RECEIVABLE

## Ransky, Caine & Company

Following is the account of Ransky, Caine & Company, a customer in the accounts receivable ledger of a client whose accounts are being audited by you for the calendar year of 19—:

### RANSKY, CAINE & COMPANY

| | | | | | | |
|---|---|---|---|---|---|---|
| June | 30 | Balance.................. | | | | 16,111.64 |
| July | 7 | ......................... | S | 4,119.70 | | 20,231.34 |
| | 17 | ......................... | CR | | 20,231.84 | (.50) |
| | 21 | ......................... | S | 314.16 | | 313.66 |
| | 28 | ......................... | S | 300.00 | | 613.66 |
| Aug. | 3 | ......................... | S | 2,418.10 | | 3,031.76 |
| | | Freight.................. | CP | 101.07 | | 3,132.83 |
| | 5 | ......................... | S | 2,681.04 | | 5,813.87 |
| | 9 | ......................... | CR | | 614.16 | 5,199.71 |
| | 10 | C/m on invoice of Aug. 5... | RS | | 181.04 | 5,018.67 |
| | 13 | ......................... | CR | | 2,517.15 | 2,501.52 |
| | 15 | ......................... | S | 3,527.66 | | 6,029.18 |
| | | ......................... | CR | | 2,496.38 | 3,532.80 |
| | 22 | ......................... | S | 874.16 | | 4,406.96 |
| | 30 | ......................... | CR | | 3,457.11 | 949.85 |
| | 31 | ......................... | S | 1,343.21 | | 2,293.06 |
| Sept. | 3 | ......................... | S | 462.19 | | 2,755.25 |
| | 7 | ......................... | S | 2,207.62 | | 4,962.87 |
| | 9 | ......................... | CR | | 452.19 | 4,510.68 |
| | 13 | ......................... | S | 3,218.66 | | 7,729.34 |
| | 16 | ......................... | CR | | 2,107.62 | 5,621.72 |
| | 18 | ......................... | S | 1,207.81 | | 6,829.53 |
| | 25 | ......................... | CR | | 3,154.29 | 3,675.24 |
| | 27 | ......................... | CR | | 843.21 | 2,832.03 |
| Oct. | 9 | ......................... | S | 469.70 | | 3,301.73 |
| | 12 | ......................... | CR | | 500.00 | 2,801.73 |
| | 19 | ......................... | S | 411.33 | | 3,213.06 |
| Nov. | 3 | ......................... | S | 784.29 | | 3,997.35 |
| | 11 | C/m on invoice of Nov. 3... | RS | | 84.29 | 3,913.06 |
| | 20 | ......................... | S | 1,487.45 | | 5,400.51 |
| | 29 | ......................... | CR | | 600.00 | 4,800.51 |
| Dec. | 7 | ......................... | S | 2,849.60 | | 7,650.11 |
| | 9 | ......................... | CR | | 400.00 | 7,250.11 |
| | 15 | ......................... | S | 800.13 | | 8,050.24 |
| | 27 | ......................... | S | 174.14 | | 8,224.38 |
| | 31 | ......................... | CR | | 69.70 | 8,154.68 |

All sales are made on terms of 2/10, n/30.

**Required:**

(1) Through your analysis of the above account, make a list of the items which make up the balance of $8,154.68.

(2) Does the history of this account have any bearing on its valuation for purposes of the balance sheet? Explain.

## Lukens-Byril Company

On December 31, 19—, the accounts receivable of the Lukens-Byril Company, $195,954.26, consisted of the following items:

| | |
|---|---|
| Accounts Receivable, trade, of which there are $3,109.16 of known worthless accounts. Of the remaining accounts, $5,000.00 may be estimated as being of doubtful collectibility | $129,067.13 |
| Accounts Receivable, trade, credit balances | (3,612.87) |
| Accounts Receivable, consignments (cost of goods on consignment, $10,000.00) | 15,000.00 |
| Accounts Receivable consisting of subscriptions to capital stock. This is the balance due on 200 shares of capital stock subscribed for at par ($100.00) and payable on demand | 13,000.00 |
| Advances to traveling salesmen | 5,000.00 |
| Carl E. Vinson, plant superintendent | 2,000.00 |
| This is the balance due on a loan of $3,000.00 which is being paid by deductions of $100.00 monthly from Mr. Vinson's salary checks. | |
| George A. Hetzler, office employee | 500.00 |
| A salary advance to be repaid by deductions of $50.00 monthly from salary checks commencing with Mr. Hetzler's check for the month of March. | |
| Advances to Lukens Sales Company | 20,000.00 |
| Advances to Byril Engineering Company | 15,000.00 |
| These two advances to subsidiary companies are not expected to be paid during the coming year. | |
| | $195,954.26 |

**Required:**

How would the above items be classified and valued on the balance sheet of December 31, 19—? What adjustments should be made on the audit working papers? Explain how these items would be verified.

## Stewart Sales Company, Inc.

The following five accounts appeared in the general ledger of the Stewart Sales Company, Inc., on December 31 of the past calendar year:

| | | |
|---|---|---|
| Accounts Receivable | $202,379.53 | |
| Reserve for Bad Debts | | $ 3,121.11 |
| Sales | | 1,064,923.72 |
| Returned Sales and Allowances | 25,486.19 | |
| Bad Debts Expense | 0.00 | |

Over the preceding five years the company had experienced an average annual loss on uncollectible accounts receivable amounting to 1% of net sales. All accounts receivable of prior years have been collected or have been written off as uncollectible. It is not known which of the accounts receivable outstanding on December 31 of the past calendar year will become uncollectible although it is expected that the average of the preceding five years will continue.

The accounts receivable subsidiary ledger on December 31 consisted of the following accounts:

| | |
|---|---|
| Avery & Son, Inc. | $ 10,416.27 |
| Beck, Lewis P. | 4,826.41 |
| Brown, Irving J. | 1,933.81 |
| Conrad-Carleton Company | (112.94) |
| Dawson Contractors, Inc. | 17,201.13 |
| Donald & Garth | 14,201.16 |
| Eastern Air Lines, Inc. (permanent cash deposit to cover purchase of commutation tickets) | 1,000.00 |
| Elwood, Martin E. (salesman's advance) | 500.00 |
| Evans & Levy | 8,974.26 |
| Geary & Hughes (consignment, billed at 50% over cost) | 4,044.00 |
| Hoffman Distributing Company | 11,874.22 |
| Kruger & Co., Raymond C. | 15,636.46 |
| Longwell, Frank C. | (113.89) |
| McKinney, Louis T. | 7,874.00 |
| Oliver & Co., James T. | 15,207.14 |
| Sears, Bradford & Company | 10,107.62 |
| Stewart, John J. (cash loan to president of Stewart Sales Co., Inc., due 3 years from now) | 10,000.00 |
| Stewart Supply Company (affiliated company) | 38,621.65 |
| Van Wie & Stevens, Inc. | 30,188.23 |
| | $202,379.53 |

**Required:**

How should the above accounts receivable be valued and classified on the balance sheet of December 31, 19—? How should they be verified?

## Otis & Company

In your audit of Otis & Company for the past calendar year you find the following accounts:

ACCOUNTS RECEIVABLE

| | | | | | |
|---|---|---|---|---|---|
| 19— | | | 19— | | |
| Jan. 1 | Balance | 836,074.12 | Jan.–Dec. | Collections | 5,871,818.28 |
| Jan.–Dec. | Sales | 6,269,388.20 | Jan.–Dec. | Write-offs | 29,992.91 |
| | | | Dec. 31 | Balance | 1,203,651.13 |
| | | 7,105,462.32 | | | 7,105,462.32 |
| 19— | | | | | |
| Jan. 1 | Balance | 1,203,651.13 | | | |

RESERVE FOR BAD DEBTS

| | | | | | |
|---|---|---|---|---|---|
| 19— | | | 19— | | |
| Jan.–Dec. | Write-offs of last year's receivables | 20,118.79 | Jan. 1 | Balance | 84,108.12 |
| | Write-offs of this year's receivables | 9,874.12 | Dec. 31 | This year's provision | 313,469.41 |
| Dec. 31 | Balance | 367,584.62 | | | |
| | | 397,577.53 | | | 397,577.53 |
| | | | Jan. 1 | Balance | 367,584.62 |

In your examination you find that the balance of Accounts Receivable represents sales of the current audit year only; that credit balances in the subsidiary ledger for accounts receivable total $74,061.88; and that the current year's provision for bad debts expense was 5% of sales (as compared with 4½% last year, 4% the year before, and 3½% the next previous year). Sequential to aging the accounts receivable, you and the company's treasurer agree on $25,000.00 as the probable loss to be sustained on collection of the accounts receivable currently outstanding as of December 31, 19—. Only one account (for $36,000.00) had a maturity of more than 12 months from December 31, 19—; this account was considered an A1 credit risk.

**Required:**

(1) Working papers in support of accounts receivable on the balance sheet.

(2) Show how the accounts receivable should appear on the audited balance sheet.

## Blair Plumbing Supply Company

In your audit of the accounts receivable ledger of the Blair Plumbing Supply Company, you examined the following account, among others:

JOHN E. STONE & SONS

| | | | | | |
|---|---|---|---|---|---|
| Sept. 19 | #47152 | 6,724.26 | Jan. 10 | CR7 | 7,760.44 |
| 26 | #49104 | 1,036.18 | | | |

Invoice terms were 1% cash discount for payment by the 10th of month following date of invoice, net 60 days.

After circularizing the accounts receivable, as of December 31, 19—, the following letter was received by you from the above customer:

John Doe & Company, C.P.A.'s
1026 Union Bank Building
Union City, Maine

Gentlemen:

In reply to your request of January 9 for a confirmation of our account with the Blair Plumbing Supply Company as of December 31, 19—, please be advised that our account was paid in full by our check of November 10th for $7,760.44 less 1%, or $7,682.84. Cancelled check for this payment, bearing proper endorsements, was received with our November bank statement. Perforation marks show payment by our bank on November 15, 19—.

Yours very truly,

John E. Stone & Sons

**Required:**

What are the possible conclusions to be drawn from this letter?

## James A. Fleming & Company

The condensed balance sheet of James A. Fleming & Company on November 30, 19—, was as follows:

| *Assets* | | *Equities* | |
|---|---|---|---|
| Cash | $ 23,000.00 | Accounts Payable | $ 30,000.00 |
| Accounts Receivable | 60,000.00 | Mortgage Interest Payable | 1,250.00 |
| Inventory | 56,750.00 | 6% Mortgage Payable | 50,000.00 |
| Other Assets | 61,500.00 | Common Stock, $100.00 par | 100,000.00 |
| | | Surplus | 20,000.00 |
| | $201,250.00 | | $201,250.00 |

The company desired to improve its cash position in order to meet and discount its currently maturing obligations and it therefore approached the First Central Bank for a short-term loan. The bank refused to grant an unsecured loan but did offer to advance funds on a pledge of certain of the company's accounts receivable. The company accordingly assigned $15,000.00 of its accounts receivable and received a $10,000.00 two months' loan from the bank. After deduction of 6% bank discount, the net cash credited to the company's bank account was $9,900.00.

During the month of December the company's condensed transactions were: sales on account, $12,000.00; collections on unassigned accounts receivable, $11,000.00; collections on assigned accounts receivable, $6,000.00; payments on accounts payable, $20,000.00; expenses paid, $4,650.00.

The company's condensed balance sheet on December 31, 19— was:

| *Assets* | | *Equities* | |
|---|---|---|---|
| Cash | $ 19,250.00 | Accounts Payable | $ 10,000.00 |
| Accounts Receivable | 55,000.00 | Notes Payable | 4,000.00 |
| Inventory | 49,250.00 | Mortgage Interest Payable | 1,500.00 |
| Other Assets | 61,500.00 | 6% Mortgage Payable | 50,000.00 |
| | | Common Stock, $100.00 par | 100,000.00 |
| | | Surplus | 19,500.00 |
| | $185,000.00 | | $185,000.00 |

**Required:**

(1) As auditor for the company, prepare the balance sheet, December 31, 19—, that you would include in your audit report.

(2) What are some of the main points to be included in your audit program for accounts receivable?

## J. Newton Yardley Company

During your examination of the J. Newton Yardley Company for the past calendar year, the company's head bookkeeper provided you with the following analysis of accounts receivable, as of December 31, 19—:

| | Balance of Account | Current | Months Overdue 1 | 2–3 | 4+ | |
|---|---|---|---|---|---|---|
| Barton, Inc., Ray L. | $12,600 | $ 6,500 | $4,100 | $2,000 | | |
| Byrnes, David L. | 8,600 | 8,600 | | | | |
| Chatfield & Son, C. C. | 7,680 | 7,680 | | | | |
| Colton & Co., R. D. | 7,500 | 7,500 | | | | A special sale of slow merchandise, terms ⅓ payable in 12 months, ⅔ in next 12 months, with a special discount of 10% if paid in full within 6 months. |
| Crouse, Milton F. | 7,800 | | | | $7,800 | |
| Fraser & Thompson, Inc. | 11,300 | 7,400 | 3,900 | | | |
| Klein & Feld | 874 | | | | 874 | In bankruptcy, no recovery probable. Account is 11 months old and should be written off. |
| Nevins & Co., Henry P. | 1,200 | | | | 1,200 | |
| Rosen, David L. | (300) | (300) | | | | C/m for returned mdse. |
| Shelley & Gray | 2,070 | 2,070 | | | | |
| Travis, Elton B. | 4,200 | 4,200 | | | | Mdse. shipped on consignment, Sales credited. (Cost, $3,000). |
| Treat, Marvin & Sons | 3,000 | 3,000 | | | | Mdse. shipped on consignment, Sales credited. (Cost, $2,000). One-half of this mdse. has been sold on credit. Consignee's commission, 10%. |
| Yardley, J. Newton | 10,000 | 10,000 | | | | A cash advance to the company's president made Oct. 1, interest at 6%, payable on demand. Approved by board of directors. |
| Yardley Sales Co., J. Newton | 18,340 | 18,340 | | | | This company 60% owned by J. Newton Yardley, and 20% by J. Newton Yardley Company. |
| | $94,864 | $74,990 | $8,000 | $2,000 | $9,874 | |

It is decided that a reserve should be created against the Nevins and Crouse accounts of $33\frac{1}{3}\%$. The credit balance in the present Reserve for Bad Debts account is $5,000, a carry-over from the preceding accounting period. The consignment accounts receivable are nontrade.

**Required:**

Show how the above accounts receivable should be valued and classified on the audited balance sheet of December 31, 19—.

## The Mellon Company

You are conducting a balance sheet audit of The Mellon Company as of December 31, 19—. The balance of the accounts receivable (control) account on the general ledger is $1,203,375.00. An analysis of this balance reveals the following information:

ACCOUNTS RECEIVABLE

| | | |
|---|---|---|
| 748,416.00 | | Debit balances in accounts with trade customers. Of this total:<br>$450,000.00 is due for payment in 3 months or less.<br>101,420.00 is due for payment in 3.1 to 6 months.<br>72,000.00 is due for payment in 6.1 to 12 months.<br>50,012.00 is due for payment in 12.1 to 18 months.<br>34,028.00 is overdue for payment by 0.1 to 3 months.<br>26,209.00 is overdue for payment by 3.1 to 6 months.<br>9,402.00 is overdue for payment by 6.1 to 9 months.<br>5,345.00 is overdue for payment by 9.1 to 12 months or more. |
| | 16,041.00 | Credit balances in accounts with trade customers. |
| 1,000.00 | | Cash deposit with Lear & Co., Inc., representing a 5% down payment on a contract for merchandise to be purchased from this company over the next 6 months. |
| 5,000.00 | | Advances to employees on future pay checks. |
| 10,000.00 | | Notes receivable (loans to employees), all due in 7 months or less. |
| 75,000.00 | | Advance to Henry R. Mellon, president. This advance is covered by an unsecured note due two years from now. |
| 50,000.00 | | Amount due on capital stock subscriptions of $150,000.00. |
| 184,000.00 | | Sales to consignment customers. The merchandise, which cost $100,000.00, now in the hands of consignees. |
| 10,000.00 | | Working fund advances to traveling salesmen. |
| 100,000.00 | | Advances to subsidiary, Baker-Mellon Company. Repayment is to be spread equally over the next five years. |
| 7,000.00 | | Predated billing on merchandise to be shipped next April 1. This merchandise has not yet been acquired by The Mellon Company for shipment. Customers are allowed a special cash discount of 1% for each month that the account is paid in advance of April 1. |
| 13,000.00 | | Sales billed December 31, 19—, the merchandise being shipped two days later. This merchandise (cost, $7,000.00) was not included in the end-of-the-year inventory of $1,385,000.00. |
| 4,000.00 | | Claims filed against railroads. |
| 12,000.00 | | Unordered merchandise shipped sight draft order bill of lading—drafts not yet collected. This merchandise cost $8,000.00. |

### *Additional Information*

Not included in the above account was $500.00 of unrecorded cash received from a customer as a 20% down payment on merchandise (now in stock) to be shipped to him on January 12, 19—.

Unrecorded cash received from customers on December 31, 19—, but received too late to deposit in the bank, $3,114.00. These collections applied to the accounts receivable of $101,420.00 above.

Accounts receivable known to be uncollectible, but not yet written off, amount to $7,812.00. Of this amount, $1,021.00 was overdue for payment by 3.1 to 6 months, $2,377.00 by 6.1 to 9 months, and $4,414.00 by 12 months or more.

There is no balance in the Reserve for Bad Debts account nor have any entries been made in this account during the year just closed.

For each of the "overdue" groupings of accounts receivable, the estimated current uncollectibility of these accounts is fixed at 15%, 30%, 45%, and 60%, respectively, of the amounts owed.

The balance of the Cash account in the ledger was $100,000.00.

**Required:**

(1) How should the above account and information appear in the balance sheet of December 31, 19-- ? Give correct classifications, account titles, and amounts.

(2) What auditing procedures should be followed for the verification of the balances of the above account? Discuss fully.

## Russell & Wheeler, Inc.

On December 31, 1952, the following three accounts appeared in the general ledger of Russell & Wheeler, Inc.:

| | | |
|---|---|---|
| Accounts Receivable | $500,000.00 | |
| Reserve for Bad Debts | | $20,000.00 |
| Reserve for Sales Discounts | | 7,500.00 |

The balances of these accounts were correct.

During the calendar year of 1953 the company made sales of $1,760,000.00 (average terms being 2% cash discount by the tenth of the month following date of sale), and collected accounts of $1,850,000.00, 80% of which were discounted payments. Included in these cash receipts were collections on the accounts receivable of December 31, 1952, as follows: $300,000.00 of accounts were paid with benefit of cash discount, $185,000.00 were paid without benefit of cash discount. The remaining accounts receivable of $15,000.00 were written off as uncollectible.

Over a period of several years the bad debts expense of the company averaged 1% of net sales (after sales discounts). The total of uncollectible accounts written off in 1953 amounted to $25,000.00

About 20% of the accounts receivable outstanding on December 31, 1953, were overdue. Of these overdue accounts, it was estimated by the credit manager that probably one fourth of them would not be collected.

**Required:**

How would you handle the above information in constructing the financial statements for 1953? How should accounts receivable be shown on the balance sheet of December 31, 1953?

## The Dexter Store

Mr. Max E. Dexter was a wholesaler of ladies' apparel doing business under the name of "Dexter's." You are conducting an examination of his accounts for the past calendar year. The condensed trial balance of December 31, 19—, prepared by his bookkeeper was:

| | | |
|---|---|---|
| Cash | $ 32,677.34 | |
| Accounts Receivable | 44,844.31 | |
| Securities, 500 shares Ley Sales Company | 30,165.74 | |
| Merchandise | 25,104.82 | |
| Delivery Equipment | 5,124.18 | |
| Accounts Payable | | $ 12,622.19 |
| Max E. Dexter, Capital | | 86,712.74 |
| Max E. Dexter, Personal | | 27,857.65 |
| Sales | | 168,515.89 |
| Cost of Sales | 101,211.44 | |
| Insurance Expense | 1,825.48 | |
| Salaries—General | 25,010.00 | |
| Salaries—Max E. Dexter | 12,000.00 | |
| Sundry Expenses | 17,745.16 | |
| | $295,708.47 | $295,708.47 |

The following accounts are reproduced as they appear in the ledger:

ACCOUNTS RECEIVABLE

| | | | | | | |
|---|---|---|---|---|---|---|
| Jan. 1 | Balance | 31,712.52 | Jan. 31 | | 26,872.41 |
| 31 | | 8,193.16 | Feb. 28 | | 6,408.07 |
| Feb. 28 | | 12,200.67 | Mar. 31 | | 10,781.29 |
| Mar. 31 | | 16,003.55 | Apr. 30 | | 13,145.88 |
| Apr. 30 | | 13,907.47 | May 31 | | 13,000.76 |
| May 31 | | 14,154.77 | June 30 | | 12,019.27 |
| June 30 | | 12,445.96 | July 31 | | 13,408.80 |
| July 31 | | 11,598.27 | Aug. 31 | | 11,426.79 |
| Aug. 31 | | 15,151.12 | Sept. 30 | | 12,001.50 |
| Sept. 30 | | 14,925.69 | Oct. 31 | | 13,104.16 |
| Oct. 31 | | 13,606.27 | Nov. 30 | | 10,118.23 |
| Nov. 30 | | 16,754.30 | Dec. 31 | | 14,782.10 |
| Dec. 31 | | 21,259.82 | | Balance | 44,844.31 |
| | | 201,913.57 | | | 201,913.57 |
| Jan. 1 | Balance | 44,844.31 | | | |

DELIVERY EQUIPMENT—48-MONTH LIFE

| | | | |
|---|---|---|---|
| Feb. 28 | 5,124.18 | | |

### Max E. Dexter, Personal

| Date | | Explanation | Amount | Date | | Explanation | Amount |
|---|---|---|---|---|---|---|---|
| Jan. | 31 | Check | 300.00 | Jan. | 1 | Balance | 12,863.15 |
| Feb. | 28 | " | 300.00 | | 31 | | 162.24 |
| Mar. | 15 | " | 5,000.00 | | | | 1,000.00 |
| | 31 | " | 300.00 | Feb. | 1 | Dividend, Ley Sales Co. | 1,250.00 |
| Apr. | 30 | " | 350.00 | | 28 | | 241.60 |
| May | 31 | " | 350.00 | | | | 1,000.00 |
| June | 30 | " | 350.00 | | | Delivery Equipment | 5,124.18 |
| July | 31 | " | 400.00 | Mar. | 31 | | 316.90 |
| Aug. | 31 | " | 400.00 | | | | 1,000.00 |
| Sept. | 30 | " | 400.00 | Apr. | 30 | | 275.40 |
| Oct. | 31 | " | 450.00 | | | | 1,000.00 |
| Nov. | 30 | " | 450.00 | May | 1 | Dividend, Ley Sales Co. | 1,250.00 |
| Dec. | 10 | " | 1,000.00 | | 31 | | 280.30 |
| | 31 | " | 450.00 | | | | 1,000.00 |
| | | Balance | 27,857.65 | June | 30 | | 246.46 |
| | | | | | | | 1,000.00 |
| | | | | July | 31 | | 229.66 |
| | | | | | | | 1,000.00 |
| | | | | Aug. | 1 | Dividend, Ley Sales Co. | 1,250.00 |
| | | | | | 31 | | 300.02 |
| | | | | | | | 1,000.00 |
| | | | | Sept. | 30 | | 295.56 |
| | | | | | | | 1,000.00 |
| | | | | Oct. | 31 | | 269.44 |
| | | | | | | | 1,000.00 |
| | | | | Nov. | 1 | Dividend, Ley Sales Co. | 1,250.00 |
| | | | | | 30 | | 331.76 |
| | | | | | | | 1,000.00 |
| | | | | Dec. | 31 | | 420.98 |
| | | | | | | | 1,000.00 |
| | | | 38,357.65 | | | | 38,357.65 |
| | | | | Jan. | 1 | Balance | 27,857.65 |

### Sales

| Date | | Ref. | Amount | Date | | Amount |
|---|---|---|---|---|---|---|
| Jan. | 31 | J | 81.12 | Jan. | 31 | 8,193.16 |
| Feb. | 28 | J | 120.80 | Feb. | 28 | 12,200.67 |
| Mar. | 31 | J | 158.45 | Mar. | 31 | 16,003.55 |
| Apr. | 30 | J | 137.70 | Apr. | 30 | 13,907.47 |
| May | 31 | J | 140.15 | May | 31 | 14,154.77 |
| June | 30 | J | 123.23 | June | 30 | 12,445.96 |
| July | 31 | J | 114.83 | July | 31 | 11,598.27 |
| Aug. | 31 | J | 150.01 | Aug. | 31 | 15,151.12 |
| Sept. | 30 | J | 147.78 | Sept. | 30 | 14,925.69 |
| Oct. | 31 | J | 134.72 | Oct. | 31 | 13,606.27 |
| Nov. | 30 | J | 165.88 | Nov. | 30 | 16,754.30 |
| Dec. | 31 | J | 210.49 | Dec. | 31 | 21,259.82 |

INSURANCE EXPENSE

| | | | | |
|---|---|---|---|---|
| Jan. 31 | | J | 81.12 | |
| Feb. 28 | | J | 120.80 | |
| Mar. 31 | | J | 158.45 | |
| | Claim paid | CP | 30.07 | |
| Apr. 30 | | J | 137.70 | |
| May 31 | | J | 140.15 | |
| June 30 | | J | 123.23 | |
| July 31 | | J | 114.83 | |
| | Claim paid | CP | 42.01 | |
| Aug. 31 | | J | 150.01 | |
| Sept. 30 | | J | 147.78 | |
| Oct 31 | | J | 134.72 | |
| | Claim paid | CP | 68.24 | |
| Nov. 30 | | J | 165.88 | |
| Dec. 31 | | J | 210.49 | |

SALARIES, MAX E. DEXTER

| | | |
|---|---|---|
| Jan. 31 | 1,000.00 | |
| Feb. 28 | 1,000.00 | |
| Mar. 31 | 1,000.00 | |
| Apr. 30 | 1,000.00 | |
| May 31 | 1,000.00 | |
| June 30 | 1,000.00 | |
| July 31 | 1,000.00 | |
| Aug. 31 | 1,000.00 | |
| Sept. 30 | 1,000.00 | |
| Oct. 31 | 1,000.00 | |
| Nov. 30 | 1,000.00 | |
| Dec. 31 | 1,000.00 | |

To each sales invoice a 1% charge for insurance is added. The total of each invoice is recorded simply as a debit to Accounts Receivable and a credit to Sales. The total of the insurance charges of each month are made the basis of a monthly entry in which, for example, each $1.00 of insurance billed is journalized as follows:

| | | |
|---|---|---|
| Insurance Expense . . . . . . . . . . . . . . . . . . . . . . . . | 1.00 | |
| Sales . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . | 1.00 | |
| Max E. Dexter, Personal . . . . . . . . . . . . . . . . . . | | 2.00 |

As a general rule the charges for insurance were accepted and paid by customers. Since no outside insurance was carried, insurance claims of customers were settled by duplicate shipments of merchandise or by cash refunds. In the course of a year the amount of such claims was very small; for the past calendar year they were $140.32.

The delivery truck was paid for by the personal check of Mr. Dexter. Income taxes are estimated at 30% of net taxable income.

**Required:**

From the information given above, prepare a profit and loss statement for the year, a balance sheet as of December 31, 19—, and a statement of capital for the year.

## Nashville & Company

The books of Nashville & Company were being audited for the year 1954 by the firm of Simmons & Gray, certified public accountants. Nashville & Company was a retailer of various kinds of durable consumer goods (refrigerators, stoves, etc.) and it extended credit liberally.

One of the problems of the auditors was the determination of a proper provision for bad debt losses for 1954. Of the accounts receivable outstanding on December 31, 1954, about

| | |
|---|---|
| $1,847,346.00 | were considered good. Of these accounts, $201,614.00 were due for payment at various dates in 1956. |
| 426,207.00 | were considered partially collectible. |
| 112,621.00 | were of doubtful collectibility. |
| $2,386,174.00 | Accounts receivable, total. |

The following statistics were applicable to the years shown:

| | *1950* | *1951* | *1952* | *1953* | *1954* |
|---|---|---|---|---|---|
| Net sales.......... | $7,204,844.00 | $7,632,114.00 | $8,311,021.00 | $8,699,874.00 | $9,411,701.00 |
| Accounts receivable, December 31.... | 786,737.00 | 1,011,777.00 | 1,341,298.00 | 1,867,159.00 | 2,386,174.00 |
| Accounts receivable written off....... | 126,877.00 | 151,092.00 | 204,018.00 | 241,627.00 | 282,144.00 |

| The accounts receivable written off had been created in the year: | And were written off in the year: | | | | |
|---|---|---|---|---|---|
| | *1950* | *1951* | *1952* | *1953* | *1954* |
| 1948 | $ 10,222.00 | | | | |
| 1949 | 19,011.00 | $ 8,989.00 | | | |
| 1950 | 97,644.00 | 41,029.00 | $ 18,943.00 | | |
| 1951 | | 101,074.00 | 56,729.00 | $ 23,660.00 | |
| 1952 | | | 128,346.00 | 68,766.00 | $ 36,964.00 |
| 1953 | | | | 149,201.00 | 81,049.00 |
| 1954 | | | | | 164,131.00 |
| | $ 126,877.00 | $ 151,092.00 | $ 204,018.00 | $ 241,627.00 | $ 282,144.00 |

When accounts receivable were determined to be worthless, they were written off against the Reserve for Bad Debts. On December 31, 1954, the Reserve for Bad Debts account had a debit balance of $61,997.00.

**Required:**

(1) What provision for bad debts should be made for 1954? How should the accounts receivable of Nashville & Company be valued? Discuss the procedures open to the auditors in arriving at an answer to this question. Prepare working papers.

(2) How should the accounts receivable of Nashville & Company appear on the balance sheet?

## Truman Sales Company

In the course of your audit of the Truman Sales Company you find the company's system of internal control to be inadequate. Among other things you find that Mr. John B. Holmes was cashier, bookkeeper, and general handy man about the office. From Mr. Harry J. Truman, president, you learn that sales on account are made on terms of 2% cash discount on the 10th day of the month following date of sale; and they are payable net on the last day of the month following the date of sale. All cash sales are made less 2% cash discount and are entered in the cash receipts book only. Mr. Truman advises that he expects and believes these terms to be strictly enforced.

The following data are taken from the records of the company:

Sales Book

| | | | | |
|---|---|---|---|---|
| Dec. | 1 | Andrews & Son | √ | 246.87 |
| | | John E. Terrell | √ | 761.55 |
| | 2 | Frank Mason | √ | 813.12 |
| | | Calhoun Sales Company | √ | 209.64 |
| | 4 | Wilcox Supply Company | √ | 568.72 |
| | | General Stores, Inc. | √ | 611.12 |
| | 5 | John E. Terrell | √ | 1,204.67 |
| | | Clark & Company | √ | 781.40 |
| | 6 | Ray & Ray | √ | 216.09 |
| | 7 | Andrews & Son | √ | 901.27 |
| | 8 | Calhoun Sales Company | √ | 417.95 |
| | 9 | John E. Terrell | √ | 516.88 |
| | 11 | General Stores, Inc. | √ | 389.57 |
| | 12 | John E. Terrell | √ | 649.52 |
| | | Clark & Company | √ | 306.12 |
| | 13 | Ray & Ray | √ | 1,294.09 |
| | 14 | Calhoun Sales Company | √ | 1,681.72 |
| | | Wilcox Supply Company | √ | 766.59 |
| | 15 | Andrews & Son | √ | 834.00 |
| | 16 | John E. Terrell | √ | 1,357.61 |
| | 18 | Clark & Company | √ | 104.69 |
| | 19 | Frank Mason | √ | 457.08 |
| | 20 | General Stores, Inc. | √ | 1,461.27 |
| | 21 | Calhoun Sales Company | √ | 1,001.01 |
| | 22 | Ray & Ray | √ | 713.22 |
| | 26 | John E. Terrell | √ | 1,500.04 |
| | | Frank Mason | √ | 761.33 |
| | 27 | Calhoun Sales Company | √ | 101.74 |
| | 28 | Wilcox Supply Company | √ | 399.99 |
| | 30 | Andrews & Son | √ | 401.50 |
| | | General Stores, Inc. | √ | 1,172.67 |
| | | | | 22,080.83 |

### Cash Receipts Book

| | | | | Credit | | | Debit | |
|---|---|---|---|---|---|---|---|---|
| | | | | *Miscellaneous* | | *Accounts Receivable* | *Sales Discounts* | *Cash* |
| Dec. | 9 | Andrews & Son | | | √ | 1,177.03 | 23.54 | 1,153.49 |
| | 10 | John E. Terrell | | | √ | 1,715.13 | 44.30 | 1,670.83 |
| | | Calhoun Sales Company | | | √ | 1,499.86 | 30.00 | 1,469.86 |
| | | Frank Mason | | | √ | 771.05 | 15.42 | 755.63 |
| | | Clark & Company | | | √ | 1,111.55 | 35.71 | 1,075.84 |
| | | General Stores, Inc. | | | √ | 811.02 | | 811.02 |
| | | Cash Sales | | 3,109.26 | | | 78.41 | 3,030.85 |
| | 15 | John E. Terrell | | | √ | 761.55 | 15.23 | 746.32 |
| | 18 | Wilcox Supply Company | | | √ | 1,068.72 | 21.37 | 1,022.15 |
| | | Freight Out | | (25.20) | | | | |
| | 19 | John E. Terrell | | | √ | 1,300.98 | 26.02 | 1,274.96 |
| | 20 | Cash Sales | | 1,211.16 | | | 42.22 | 1,168.94 |
| | | Clark & Company | | | √ | 306.12 | 6.12 | 300.00 |
| | 23 | Ray & Ray | | | √ | 216.09 | 4.32 | 211.77 |
| | 26 | John E. Terrell | | | √ | 1,548.59 | 31.97 | 1,516.62 |
| | 31 | John E. Terrell | | | √ | 2,079.16 | 41.58 | 2,037.58 |
| | | Cash Sales | | 2,316.44 | | | 92.66 | 2,223.78 |
| | | | | 6,611.66 | | 13,844.64 | 498.43 | 19,957.87 |

### Cash

| | | | | | | |
|---|---|---|---|---|---|---|
| Dec. | 1 | Balance | | | | 25,041.62 |
| | 31 | | CR | 19,957.87 | | 44,999.49 |
| | | | CP | | 22,747.88 | 22,251.61 |

### Accounts Receivable

| | | | | | | |
|---|---|---|---|---|---|---|
| Dec. | 1 | Balance | | | | 9,785.69 |
| | 31 | | S | 22,080.83 | | 31,866.52 |
| | | | CR | | 13,844.64 | 17,021.88 |

### Sales

| | | | | | | |
|---|---|---|---|---|---|---|
| Dec. | 1 | Balance | | | | 201,375.44 |
| | 10 | | CR | | 3,109.26 | 204,484.70 |
| | 20 | | CR | | 1,211.16 | 205,695.86 |
| | 31 | | CR | | 1,316.44 | 206,012.30 |
| | | | S | | 22,080.83 | 228,093.13 |

The accounts receivable subsidiary ledger consisted of the following accounts:

ANDREWS & SON

| | | | | | | |
|---|---|---|---|---|---|---|
| Nov. | 8 | | S | 834.16 | | 834.16 |
| | 8 | Freight | CP | 30.00 | | 864.16 |
| | 17 | | S | 312.87 | | 1,177.03 |
| Dec. | 1 | | S | 246.87 | | 1,423.90 |
| | 7 | | S | 901.27 | | 2,325.17 |
| | 9 | | CR | | 1,177.03 | 1,148.14 |
| | 15 | | S | 834.00 | | 1,982.14 |
| | 30 | | S | 401.50 | | 2,383.64 |

CALHOUN SALES COMPANY

| | | | | | | |
|---|---|---|---|---|---|---|
| Oct. | 10 | | S | 726.04 | | 726.04 |
| Nov. | 16 | | S | 271.65 | | 997.69 |
| | 27 | | S | 394.18 | | 1,391.87 |
| | 30 | | S | 107.99 | | 1,499.86 |
| Dec. | 2 | | S | 209.64 | | 1,709.50 |
| | 8 | | S | 417.95 | | 2,127.45 |
| | 10 | | CR | | 1,499.86 | 627.59 |
| | 14 | | S | 1,681.72 | | 2,309.31 |
| | 21 | | S | 1,001.01 | | 3,310.32 |
| | 27 | | S | 101.74 | | 3,412.06 |

CLARK & COMPANY

| | | | | | | |
|---|---|---|---|---|---|---|
| Nov. | 17 | | S | 1,785.66 | | 1,785.66 |
| | 24 | | RS | | 674.11 | 1,111.55 |
| Dec. | 5 | | S | 781.40 | | 1,892.95 |
| | 10 | | CR | | 1,111.55 | 781.40 |
| | 12 | | S | 306.12 | | 1,087.52 |
| | 18 | | S | 104.69 | | 1,192.21 |
| | 20 | | CR | | 306.12 | 886.09 |

GENERAL STORES, INC.

| | | | | | | |
|---|---|---|---|---|---|---|
| Nov. | 30 | | S | 811.02 | | 811.02 |
| Dec. | 4 | | S | 611.12 | | 1,422.24 |
| | 10 | | CR | | 811.02 | 611.12 |
| | 11 | | S | 389.57 | | 1,000.69 |
| | 20 | | S | 1,461.27 | | 2,461.96 |
| | 30 | | S | 1,172.67 | | 3,634.63 |

FRANK MASON

| | | | | | | |
|---|---|---|---|---|---|---|
| Nov. | 14 | | S | 561.87 | | 561.87 |
| | 26 | | S | 209.18 | | 771.05 |
| Dec. | 2 | | S | 813.12 | | 1,584.17 |
| | 10 | | CR | | 771.05 | 813.12 |
| | 19 | | S | 457.08 | | 1,270.20 |
| | 26 | | S | 761.33 | | 2,031.53 |

RAY & RAY

| | | | | | | |
|---|---|---|---|---|---|---|
| Dec. | 6 | | S | 216.09 | | 216.09 |
| | 13 | | S | 1,294.09 | | 1,510.18 |
| | 22 | | S | 713.22 | | 2,223.40 |
| | 23 | | CR | | 216 | 2,007.31 |

JOHN E. TERRELL

| | | | | | | |
|---|---|---|---|---|---|---|
| Nov. | 1 | | S | 104.62 | | 104.62 |
| | 9 | | S | 1,610.51 | | 1,715.13 |
| | 16 | | S | 1,300.98 | | 3,016.11 |
| | 27 | | S | 899.07 | | 3,915.18 |
| Dec. | 1 | | S | 761.55 | | 4,676.73 |
| | 5 | | S | 1,204.67 | | 5,881.40 |
| | 9 | | S | 516.88 | | 5,398.28 |
| | 10 | | CR | | 1,715.13 | 3,683.15 |
| | 12 | | S | 649.52 | | 4,332.67 |
| | 15 | | CR | | 761.55 | 3,571.12 |
| | 16 | | S | 1,357.61 | | 4,928.73 |
| | 19 | | CR | | 1,300.98 | 3,627.75 |
| | 26 | | S | 1,500.04 | | 5,127.79 |
| | 26 | | CR | | 1,548.59 | 3,579.20 |
| | 31 | | CR | | 2,079.16 | 1,500.04 |

WILCOX SUPPLY COMPANY

| | | | | | | |
|---|---|---|---|---|---|---|
| Nov. | 16 | | S | 500.00 | | 500.00 |
| Dec. | 4 | | S | 568.72 | | 1,068.72 |
| | 14 | | S | 766.59 | | 1,835.31 |
| | 18 | | CR | | 1,068.72 | 766.59 |
| | 28 | | S | 399.99 | | 1,166.58 |

Bank deposits for the month of December totaled $19,957.87, as per duplicate deposit slips stamped by the bank. These deposits represented December business only, i.e., there were no November collections to be carried over into December deposits.

Although terms on both shipments were f.o.b. destination, no freight bills could be found to support the deduction of $25.20 appearing in the cash receipts book entry of December 18.

The bank statement and confirmation showed a balance in the bank of $22,251.61.

**Required:**

Analyze the above information. Present a summary of your finding for inclusion in your file of audit working papers.

# 5. NOTES RECEIVABLE

## Maynard & Company

On December 31, 19—, the Notes Receivable account of Maynard & Company consisted of the following notes:

| | |
|---|---|
| Trade notes receivable, considered good: | |
| Due in 12 months or less | $ 71,586.29 |
| Due in more than 12 months | 11,874.88 |
| Trade notes receivable, considered 80% collectible: | |
| Due in 12 months or less | 41,089.60 |
| Trade notes receivable, considered worthless | 2,049.88 |
| Trade notes receivable, considered good, and discounted with the First National Bank (with offsetting credits to Notes Receivable Discounted.) Of these notes, $21,462.66 have been paid | 64,712.39 |
| Notes receivable accepted on sale of diesel equipment (fixed asset), $18,000.00. This amount was payable $500.00 monthly; and the purchaser was considered a first-class credit risk | 18,000.00 |
| Note receivable of Tom J. Maynard, president, payable on demand. This note was received in payment of his subscription to 1,000 shares of common stock of Maynard & Company at par. Upon receipt of this note, the corporation issued a certificate of capital stock for 1,000 shares | 100,000.00 |
| | $309,313.04 |

**Required:**

How should the company's notes receivable appear on the audited balance sheet of December 31, 19—? How should they be verified?

## Joyner Brothers, Inc.

During your audit of Joyner Brothers, Inc., as of December 31, 19—, you find the following Notes Receivable accounts:

NOTES RECEIVABLE

| | | | | | |
|---|---|---|---|---|---|
| Sept. 11 | T. Parker Emerson, 3 months, 4% | 300.00 | Sept. 11 | Emerson note discounted at 6% | 298.45 |
| Oct. 1 | John W. Dillon, 6 months, 6% | 600.00 | Nov. 30 | Hyde note discounted at 6% | 940.00 |
| Nov. 1 | Carl E. Haney 1 month, 8% | 200.00 | | | |
| 30 | Neal A. Hyde, 12 months, no interest | 1,000.00 | | | |
| Dec. 1 | Kyle & Kraft, 6 months, 6% | 500.00 | | | |
| 10 | Henry S. Michael, payable $\frac{1}{3}$ in 12 months, $\frac{2}{3}$ in 24 months, 6% | 3,600.00 | | | |
| 20 | Bruce T. Joyner, 3 months, no interest. This is a loan to the company's president | 5,000.00 | | | |

NOTES RECEIVABLE DISCOUNTED

| | | | | | |
|---|---|---|---|---|---|
| Sept. 11 | J | 300.00 | | | |
| Nov. 30 | J | 1,000.00 | | | |

NOTES RECEIVABLE DISCOUNTED

| | | | | | |
|---|---|---|---|---|---|
| | | | Sept. 11 | J | 300.00 |
| | | | Nov. 30 | J | 1,000.00 |

You are informed by the Border State Bank that the Emerson note was paid on December 15, 19—.

**Required:**

Prepare audit working papers for notes receivable. How should notes receivable appear on the audited balance sheet?

## Alan P. Gantley Company

Unless otherwise identified, the notes receivable of the Alan P. Gantley Company on December 31, 19—, were trade notes receivable. On this date the balance of the account, $30,369.15, consisted of the following notes—all received during the calendar year under audit:

| *Maker* | *Date* | *Term* | *Interest* | *Amount* | *Remarks* |
|---|---|---|---|---|---|
| Allen, Russell & Co. | Oct. 1 | 6 months | 6% | $ 574.16 | Four notes to settle past due account receivable. Current billings are on a 10-day credit basis. |
| " " " | Oct. 1 | 12 months | 6% | 1,000.00 | |
| " " " | Oct. 1 | 18 months | 6% | 1,000.00 | |
| " " " | Oct. 1 | 24 months | 6% | 1,000.00 | |
| Carleton, Henry B. | July 1 | 36 months | 6% | 5,000.00 | This note is for a cash loan made to this customer. No interest has been collected to date. |
| Duncan & Co., L. B. | Oct. 1 | 4 months | 5% | 2,516.36 | All interest collected on October 1. |
| Gantley, Alan P. | Feb. 1 | Demand | 6% | 10,000.00 | Loan approved in minute book, January 20. On August 1 this note was pledged as collateral for a bank loan of $15,000.00. |
| Griffith, John R. | Nov. 1 | 12 months | 5% | 5,463.87 | Interest payable at maturity. |
| Reed & Son, A. E. | Dec. 10 | 90 days | 6% | 3,814.76 | Interest payable at maturity. |
| | | | | $30,369.15 | |

All of the above notes are considered good except that of Allen, Russell & Company which is somewhat doubtful. A reserve of 25% should be established against the notes receivable of this company.

### Required:

Prepare audit working papers for notes receivable. How should notes receivable appear on the audited balance sheet?

# 6. SECURITIES

## Sidney B. Gaynes & Company

On December 31, 19—, the Securities account of Sidney B. Gaynes & Company had a balance of $90,656.00 as follows:

| | *Cost* | *Market Price on December 31, 19—* |
|---|---|---|
| Packard Sporting Goods Company, 1,000 shares common stock | $20,416.00 | $17,000.00 |
| Formidon Mills, Inc., 500 shares common stock | 30,230.00 | 38,125.00 |
| Detroit Automobile Company, 1,000 shares common stock | 40,010.00 | 29,500.00 |
| | $90,656.00 | |

**Required:**

How should these securities appear on the balance sheet if: (a) they were held as short-term investments of working capital, and (b) they were held as long-term investments?

## Gerald J. Moore

In your audit for the past calendar year of 19— of the books of Gerald J. Moore, owner and operator of a number of large apartment houses and other real estate projects, you find the following account:

LYNCH, REYNOLDS & COMPANY

| | | | |
|---|---|---|---|
| April 18 | CP 89 | 150,000.00 | |

Actually this was a margin account carried with the stock brokerage firm of Lynch, Reynolds & Company. You find that 5,000 shares of General Rayon Company common stock had been purchased on April 17 of the current audit year at a price of 40, and that a margin deposit of $150,000.00 had been made on the following day, April 18.

**Required:**

How should this asset appear on the balance sheet if the current market price of General Rayon on December 31, 19—, was 61? 31? How would you audit this account?

## Goldman Enterprises, Inc.

During the course of your audit of the Goldman Enterprises, Inc., for the past calendar year, you examined the following accounts in the general ledger:

STOCK IN PARAMONT TELEVISION COMPANY

| | | | | | | |
|---|---|---|---|---|---|---|
| (past year) | | | | (past year) | | |
| July 9 | 100,000 shares | CP39 | 876,014.90 | Dec. 30 | J76 | 876,014.90 |
| (this year) | | | | | | |
| Jan. 19 | 100,000 shares | J2 | 1,104,619.87 | | | |

JOHN A. GOLDMAN, PRESIDENT

| | | | | | | |
|---|---|---|---|---|---|---|
| (past year) | | | | (this year) | | |
| Dec. 30 | | J76 | 1,104,619.87 | Jan. 19 | J2 | 1,104,619.87 |

PROFIT AND LOSS

| | | | | | | |
|---|---|---|---|---|---|---|
| (past year) | | | | (past year) | | |
| Dec. 31 | Balance | | 197,016.82 | Dec. 30 | J76 | 228,604.97 |
| 31 | To close | J77 | 31,588.15 | | | |
| | | | 228,604.97 | | | 228,604.97 |

The 100,000 shares represented a 20% stock interest in the Paramont Television Company. Their current market value on December 30th was $1,104,619.87.

**Required:**

How should the above accounts be handled in preparing the auditor's financial statements? Should this question be answered differently if the "sale" of December 30th had been made through a broker?

## Sparks Manufacturing Company

On December 31, 19—, the Marketable Securities account of the Sparks Manufacturing Company had a balance of $102,980.00. The account, in detail, was:

MARKETABLE SECURITIES

| | | Shares | | | | | Shares | |
|---|---|---|---|---|---|---|---|---|
| Jan. | 10 Rucker Dye | 100 | 4,000.00 | Oct. | 1 | Austin & Lyle | 300 | 16,800.00 |
| Apr. | 17 Clyde Bearing | 400 | 12,880.00 | Dec. | 1 | Clyde Bearing, | | |
| June | 3 Austin & Lyle | 700 | 29,400.00 | | | 400 rights | | 500.00 |
| Oct. | 21 Sparks Mfg. Co. | 300 | 30,000.00 | | | | | |
| Nov. | 29 Linden-Will Co. | 500 | 44,000.00 | | | | | |

All of the above transactions occurred during the calendar year which you are auditing.

The Clyde Bearing Company issued rights on November 15, 19—, entitling the recipient of rights to buy 1 new share of common stock at 50 for each 5 rights. When the rights were received on November 15, the market price of the rights was $1.00, and the stock ex-rights, $55.00. When they were sold on December 1 the market price of the rights was $1.25, and the stock ex-rights, $57.50.

On December 31, 19—, market prices on the above securities were: Rucker Dye, 44; Clyde Bearing, 58; Austin & Lyle, 35; Sparks Manufacturing Company, 100; Linden-Will Company, 84.

**Required:**

(1) Auditor's working papers. Show adjusting entries.

(2) How should the securities on hand be valued and classified on the balance sheet?

(3) Prepare an audit program for the above account.

## The Kennedy Fund, Inc.

The investments of The Kennedy Fund, Inc., were held on a long-term basis. On December 31, 1955, you find one of the investment accounts to be as follows:

### STANDARD MOTORS, INC.

COMMON STOCK, NO-PAR

| | | | | | |
|---|---|---|---|---|---|
| 1941 | | | 1955 | | |
| July 1 | 2,000 shares | 140,000.00 | Feb. 1 | 2,500 shares | 200,000.00 |
| 1948 | | | | | |
| Oct. 1 | 2,000 shares, stock dividend, at market price (Surplus, credited) | 80,000.00 | | | |
| 1952 | | | | | |
| May 31 | 1,000 shares at 40, by exercise of rights | 40,000.00 | | | |

On receipt of the rights in 1952, relevant market prices were: stock ex-rights, 48; rights, 2. On May 31, 1952, relevant market prices were: stock ex-rights, 52; rights, 2.40.

Half of the investment in the stock of Standard Motors, Inc., was sold on February 1, 1955, at a price of 80. On December 31, 1955, the market price of Standard Motors, Inc., was 75.

**Required:**

(1) What adjusting entries should the auditor place on his working papers for this account?

(2) How should the above investment be classified and valued in the balance sheet of December 31, 1955?

## Idaho Metals Company

The Idaho Metals Company of Hayden Lake, Idaho, had acquired a controlling interest in a promising local company, the Anaconda Nickel Company of Coeur d'Alene, Idaho. During your audit of the company's accounts for the past calendar year of 19—, which was a first audit, you found the following two accounts in the general ledger:

INVESTMENT IN ANACONDA NICKEL COMPANY

| | | *Shares* | | | | *Shares* | |
|---|---|---|---|---|---|---|---|
| 1947 | | | | 19— | | | |
| Aug. | 1 | 1,000 at 30 | 30,000.00 | July | 15 | 5,000 at 80 | 400,000.00 |
| 1948 | | | | | | | |
| Jan. | 2 | 2,000 at 35 | 70,000.00 | | | | |
| 1949 | | | | | | | |
| July | 7 | 4,000 at 50 | 200,000.00 | | | | |
| 1950 | | | | | | | |
| Oct. | 11 | 5,000 at 60 | 300,000.00 | | | | |
| 19— | | | | | | | |
| Mar. | 5 | 3,000 at 70 | 210,000.00 | | | | |

INVESTMENT IN ANACONDA URANIUM COMPANY

| | | | | | |
|---|---|---|---|---|---|
| 19— | | | | | |
| Aug. | 10 | 1,000.00 | | | |

DIVIDEND INCOME

| | | | | | |
|---|---|---|---|---|---|
| | | | 19— | | |
| | | | Jan. | 2 | 12,000.00 |
| | | | Apr. | 1 | 15,000.00 |
| | | | July | 1 | 15,000.00 |
| | | | Aug. | 10 | 1,000.00 |
| | | | Oct. | 1 | 10,000.00 |
| | | | Dec. | 20 | 10,000.00 |

The transactions of the audit year 19— may be described as follows:

Jan. 2 Received a cash dividend (declared on December 1) of $1.00 per share.

Mar. 5 Bought 3,000 shares at 70.

Apr. 1 Received a cash dividend (declared on March 1 to stock of record, March 10) of $1.00 per share.

July 1 Received a cash dividend (declared on June 1) of $1.00 per share.

15 Sold 5,000 shares at 80.

Aug. 10 Received an "extra" dividend in stock of one share Anaconda Uranium Company for each ten shares of Anaconda Nickel Company. The dividend stock had a market value of $3.00 per share and its book value on the ledger of the Anaconda Nickel Company was $1.00 per share.

Oct. 1 Received a cash dividend of $1.00 per share.

Dec. 20 Received a cash dividend of $1.00 per share, declared December 1 out of the company's "reserve for depletion" funds.

**Required:**

For purposes of the audited financial statements, what should be the balances of the above two accounts? Prepare working papers in support of your findings. (It may be assumed that sale and purchase prices per share include brokers' commissions.)

# The Green Orchid Fund, Inc.

The following four accounts reflect the securities transactions of The Green Orchid Fund, Inc., for the past calendar year:

## BLUE RIDGE FOODS, INC.

COMMON STOCK

| | | | *Shares* | | | |
|---|---|---|---|---|---|---|
| Jan. | 17 | Purchase | 100 | 2,900.00 | | 2,900.00 |
| Mar. | 20 | Purchase | 200 | 6,400.00 | | 9,300.00 |
| July | 9 | Purchase | 100 | 3,500.00 | | 12,800.00 |
| Aug. | 31 | Purchase | 300 | 11,700.00 | | 24,500.00 |
| Oct. | 25 | Sale | 200 | | 9,200.00 | 15,300.00 |

## CALORON CHEMICAL COMPANY

COMMON STOCK

| | | | *Shares* | | | |
|---|---|---|---|---|---|---|
| Feb. | 2 | Purchase | 100 | 8,000.00 | | 8,000.00 |
| June | 30 | Raised to par value, offset credit to Surplus | | 2,000.00 | | 10,000.00 |
| July | 1 | Stock dividend, offset credit to Surplus | 100 | 10,000.00 | | 20,000.00 |
| Sept. | 30 | Sale | 100 | | 5,000.00 | 15,000.00 |

## DUTCHESS DAIRY PRODUCTS, INC.

COMMON STOCK

| | | | *Shares* | | | |
|---|---|---|---|---|---|---|
| Sept. | 5 | Purchase | 1000 | 92,000.00 | | 92,000.00 |
| | 10 | Cash dividend to stock of record, Sept. 6 | | | 3,000.00 | 89,000.00 |
| | 25 | Purchase | 3000 | 306,000.00 | | 395,000.00 |
| Nov. | 7 | Sale | 2000 | | 220,000.00 | 175,000.00 |
| Dec. | 26 | Cash dividend to stock of record, Dec. 20 | | | 10,000.00 | 165,000.00 |

## 4% WARWICK STADIUM, 20 YEAR DEBENTURE BONDS

INTEREST JANUARY 1 AND JULY 1

| | | | *No.* | | | |
|---|---|---|---|---|---|---|
| Jan. | 15 | Purchase at par | 50 | 50,083.33 | | 50,083.33 |
| July | 1 | Interest | | | 1,000.00 | 49,083.33 |
| Dec. | 31 | Sale at 102, less commission of $100.00 | 25 | | 25,900.00 | 23,183.33 |

**Required:**

Prepare audit working papers for the above securities. What should be the value of Marketable Securities on the balance sheet of December 31, 19—? On December 31, 19—, current market prices were: Blue Ridge, 41; Caloron, 39; Dutchess, 109; Warwick Stadium bonds, 100–105 quoted (no market transactions in December.)

## Mason-Dixie Corporation

During their audit of the Mason-Dixie Corporation for the past calendar year, McNeil & Jones, auditors, examined the following account in the ledger:

MARKETABLE SECURITIES

| | | *Shares* | *Price* | | | | *Shares* | *Price* | |
|---|---|---|---|---|---|---|---|---|---|
| Jan. 12 | Allied Oil | 1,000 | 30 | 30,000.00 | June 20 | Crane Shoe | 300 | 18 | 5,400.00 |
| Feb. 7 | Parker Mines | 100 | 60 | 6,000.00 | Aug. 17 | Allied Oil | 200 | 45 | 9,000.00 |
| Mar. 20 | Crane Shoe | 300 | 10 | 3,000.00 | Oct. 25 | Parker Mines | 200 | 95 | 19,000.00 |
| Apr. 14 | Hudson Powder | 1,000 | 42 | 42,000.00 | Dec. 31 | Hudson | | | |
| May 21 | Jarvis Can | 800 | 59 | 47,200.00 | | Powder, | | | |
| June 6 | Allied Oil | 1,000 | 40 | 40,000.00 | | 1,000 rights | | 10¼ | 10,250.00 |
| | Parker Mines | 300 | 70 | 21,000.00 | | | | | |
| July 12 | Crown Sugar | 500 | 82 | 41,000.00 | | | | | |
| Aug. 8 | Mason-Dixie | 400 | 61 | 24,400.00 | | | | | |
| Sept. 29 | Jarvis Can | 1,200 | 68 | 81,600.00 | | | | | |
| Oct. 1 | Spicer Cigar | 700 | 27 | 18,900.00 | | | | | |
| Nov. 22 | Mason-Dixie | 600 | 62 | 37,200.00 | | | | | |
| Dec. 10 | Crane Shoe | 200 | 17 | 3,400.00 | | | | | |

The balance of the account, December 31, 19—, was $352,050.00. All of the above transactions occurred during the year being audited.

The auditors found that the physical inventory of securities on hand at the close of the year was in agreement with the above account. All stock was of no-par value.

Current market prices on December 31, 19—, were:

| | | | | | |
|---|---|---|---|---|---|
| Allied Oil | 53 | Hudson Powder | 50 | Mason-Dixie | 60 |
| Parker Mines | 70 | Jarvis Can | 60 | Spicer Cigar | 25 |
| Crane Shoe | 15 | Crown Sugar | 58 | | |

The rights sold on December 31 represented the right to purchase one new share at 30 for each share owned. For purposes of determining gain or loss on the rights sold, market values were: rights, 10; stock ex-rights, 50.

**Required:**

(1) Auditor's adjusting entries, if any.

(2) Auditor's presentation of marketable securities on the balance sheet of December 31, 19—.

## Harry C. Hepner Corporation

On December 31, 1950, the marketable securities of the Harry C. Hepner Corporation were carried in the ledger in two accounts, Stocks, $46,820.00 and Bonds, $11,830.00. The detail supporting these two accounts was as follows:

### BELMONT GENERAL CORPORATION

| | | *Shares* | | | | *Balance* |
|---|---|---|---|---|---|---|
| 1950 | | | | | | |
| Jan. | 17 | 100 | CP | 1,600.00 | | 1,600.00 |
| Mar. | 3 | 300 | CP | 5,700.00 | | 7,300.00 |
| June | 11 | 200 | CP | 4,400.00 | | 11,700.00 |
| Aug. | 13 | 500 | CP | 10,500.00 | | 22,200.00 |
| Sept. | 16 | 400 | CP | 9,200.00 | | 31,400.00 |
| Oct. | 29 | 500 | CR | | 15,000.00 | 16,400.00 |
| Dec. | 19 | 500 | CR | | 18,000.00 | (1,600.00) |

### BILTMORE PLAZA CORPORATION

| | | | | | | |
|---|---|---|---|---|---|---|
| 1940 | | | | | | |
| Jan. | 17 | 300 | CP | 9,720.00 | | 9,720.00 |
| 1948 | | | | | | |
| April | 8 | 200 | CP | 9,400.00 | | 19,120.00 |
| July | 11 | 100 | CP | 4,000.00 (a) | | 23,120.00 |
| 1950 | | | | | | |
| Oct. | 22 | 300 | CR | | 25,200.00 | (2,080.00) |

### COMMODORE COMPANY

| | | | | | | |
|---|---|---|---|---|---|---|
| 1950 | | | | | | |
| Feb. | 16 | 1,000 | CP | 43,500.00 | | 43,500.00 |
| July | 1 | 500 (b) | | | | 43,500.00 |
| Nov. | 6 | 700 | | | 28,000.00 | 15,500.00 |

### THE WALDORF TRUST COMPANY

| | | | | | | |
|---|---|---|---|---|---|---|
| 1950 | | | | | | |
| May | 6 | 1,000 | CP | 39,000.00 | | 39,000.00 |
| Dec. | 16 | 1,000 rights | CR | | 4,000.00 (c) | 35,000.00 |

## 5% CLAYDON CORPORATION BONDS OF 1960

INTEREST JANUARY 1 AND JULY 1

| | | | | | | |
|---|---|---|---|---|---|---|
| 1950 | | *Par* | | | | |
| June | 30 | 20,000.00 | CP | 18,924.00 | | 18,924.00 |
| July | 1 | Interest | CR | | 500.00 | 18,424.00 |
| Oct. | 1 | 6,000.00 | CR | | 6,244.00 (d) | 12,180.00 |
| Dec. | 31 | Interest | J | | 350.00 | 11,830.00 |

(a) By exercise of 500 rights (market values: stock ex-rights, $52.00; rights $2.00).
(b) Stock dividend.
(c) By sale of 1,000 rights (market values: stock ex-rights, $46.00; rights $4.00).
(d) Including accrued interest receivable.

On December 31, 1950, current market prices on the above securities were: Belmont General Corporation, 35; Biltmore Plaza Corporation, 86; Commodor Company, 37; Waldorf Trust Company, 45; Claydon Corporation bonds, 90.

**Required:**

(1) Adjusting entries to be incorporated in the working papers supporting your audit of these securities. Use the FIFO basis.

(2) Show how both Stocks and Bonds should appear on the balance sheet of the Harry C. Hepner Corporation. Do *not* consolidate these securities into Stocks and Bonds or Marketable Securities.

# Maxwell Investment Company

On December 31, 19— (last year), the Securities account of the Maxwell Investment Company, a privately owned corporation with nine stockholders, was as follows:

SECURITIES
(Held as Long-Term Investments)

| | | | | | |
|---|---|---|---|---|---|
| Jan. 1 | Balance, consisting of: Flintkote Company, 4,000 shares at 31 | 124,000.00 | Jan. 15 | Flintkote Company, 4,000 shares at 26 | 104,000.00 |
| 1 | U.S. Treasury 2's of 1967-72, bought at 100 | 100,000.00 | | | |
| 7 | Western Union 5's of 1960, bought at 86 | 86,000.00 | | | |
| 11 | Corn Products Refining Co., 1,000 preferred shares at 175 | 175,000.00 | | | |
| 14 | Continental Can Company, 10,000 shares at 36 | 360,000.00 | | | |
| 17 | Aluminum Company of America, 1,000 shares at 55 | 55,000.00 | | | |
| 22 | A. E. Staley Mfg. Co., 5,000 shares at 39 | 195,000.00 | | | |

Financial statistics (as of December 31, last year) relating to the above account were:

| | *High* | *Low* | *Close* | *Closing Bid* | *Closing Asked* | *Dividends paid per share in 19— (last year)* |
|---|---|---|---|---|---|---|
| U. S. Treasury Bonds, 2's (Sept.) 1967–72 | | | | 103.11 | 103.13 | |
| Western Union Telegraph Co. 5's of 1960 | 83¼ | 82¾ | 83¼ | | | |
| Corn Products Refining Co., 7% Preferred Stock | 173 | 172 | 172½ | 172½ | 173 | 7.00 |
| Continental Can Company | 35¼ | 34⅞ | 35 | 34⅞ | 35¼ | 1.50 |
| Aluminum Company of America | 52½ | 51¼ | 52½ | 52½ | 52⅞ | 2.00 |
| A. E. Staley Manufacturing Co. | | | | 34½ | 36 | 2.00 |

The Corn Products Refining Company stock, you find, was held by the First National Bank as collateral on a note payable for $100,000.00.

**Required:**

(1) Audit working papers for the Securities account.

(2) Prepare a detailed audit program for the examination of the Securities account.

(3) What are the source materials for the financial statistics above? Which of the above values will be used by the auditor? Explain how and why.

(4) Assume that the above six securities were to be valued by you as of today. Prepare a schedule of financial statistics similar to the one shown above.

## The Landry-Garrett Foundation

The Landry-Garrett Foundation was organized to administer the investments of a trust fund. As a general rule its purchases of securities were handled as long-term investments. On December 31, 1955, one of these investments appeared in the general ledger as follows:

WILLABEE PACKING COMPANY, $6\frac{1}{2}$'s of 1965

(PAR, $1,000,000.00, INTEREST PAYABLE JANUARY 1 AND JULY 1)

| | | | | | |
|---|---|---|---|---|---|
| 1954 | | | 1954 | | |
| July 1 | Cost, to yield 6% | 1,038,537.56 | Dec. 31 | Amortization | 1,343.87 |

On December 31, 1955, these bonds were quoted on the open market at 98.

**Required:**

How should these bonds be classified and valued on the balance sheet of December 31, 1955?

## NBC Publishing Company

For the purpose of assuring itself of a steady and long-term supply of quality paper, the NBC Publishing Company, publishers of the *NBC News and Picture Digest*, last year began to accumulate holdings of the common stock of the Windsor Paper Company, manufacturers of high-grade papers for magazines and other purposes. The Windsor Paper Company was a leader in its field; it had a long history of successful operations. Its outstanding capitalization consisted solely of $10,000,000.00 of common stock of $100.00 par value on which cash dividends of 7% annually had been paid for many years.

In your audit of the accounts of the NBC Publishing Company for the past calendar year, you find the following account on the ledger of the NBC Publishing Company:

### STOCK IN THE WINDSOR PAPER COMPANY

| | *Shares* | | *Cost* | |
|---|---|---|---|---|
| Oct. 8 | 5,000 | 94 | 470,000.00 | |
| 17 | 4,000 | 101 | 404,000.00 | |
| 25 | 3,000 | 107 | 321,000.00 | |
| 29 | 4,000 | 110 | 440,000.00 | |
| Nov. 7 | 5,000 | 126 | 630,000.00 | |
| 11 | 1,000 | 131 | 131,000.00 | |
| 19 | 2,000 | 142 | 284,000.00 | |
| 30 | 6,000 | 140 | 840,000.00 | |

As of December 31, 19—, you find the following December transactions (relating to the stock investment in the Windsor Paper Company) not recorded on the books:

Dec. 1. Received a stock dividend of 100% in common stock. All of the outstanding stock of the Windsor Paper Company, furthermore, was converted from $100.00 par value to no-par value.

Dec. 2. The Windsor Paper Company declared an extra cash dividend of $3.00 per share to stock of record December 10, payable December 31. This dividend "payable out of the profits of the current year" was actually collected on January 3, 19—.

Dec. 8. Bought 10,000 shares of common stock at 75.

Dec. 15. The Windsor Paper company declared a dividend payable in the stock of its affiliate, The Windsor Ink Company—one share of Windsor Ink being payable on each 10 shares of the Windsor Paper Company. The dividend was payable on January 2 to stock of record of December 20. The average unit cost of these shares was 37 although the current market was approximately 74.

Dec. 21. The Windsor Paper Company declared a special cash dividend of $30.00 per share "payable out of the earned surplus of prior years." The dividend was payable January 10, 19—, to stock of record of December 30, 19—.

**Required:**

(1) What adjusting entries, if any, would you place on your working papers for the above stock account? (NOTE.—Following the philosophy of a "clean" surplus, the only entries in the Earned Surplus account for the year should be for net income and for dividends paid.)

(2) If the current market on Windsor Paper Company common stock was 70 on December 31, 19—, show how the investment in this common stock would appear on the balance sheet.

## Aerator Sales Company

During your examination of the Aerator Sales Company for the past calendar year, you find a balance on December 31, 19—, in the Marketable Securities account of $173,805.00. This balance was made up of the following debits and credits:

DEBITS

| | | Description | Bonds | Shares Preferred | Shares Common | Ctf. | Cost |
|---|---|---|---|---|---|---|---|
| Jan. | 1 | Balance, consisting of: | | | | | |
| | | Antex Company............... | | | 1,000 | #4655 | $ 50,000.00 |
| | | " " ............... | | | 2,000 | #5899 | 90,000.00 |
| | | " " ............... | | | 1,000 | #6488 | 56,000.00 |
| | | " " ............... | | | 500 | #6609 | 28,000.00 |
| | | Collins Bearing Company....... | | | 100 | #CH5159 | 7,500.00 |
| | | Fairfax Arms, Inc., 5% 1st mortgage, Feb. & Aug., due 12 years from January 1 of this year... | 20,000.00 | | | #974–93 | 17,680.00 |
| | | | | | | | 249,180.00 |
| Mar. | 31 | Bryant Pump Company.......... | | | 500 | #22117 | 12,125.00 |
| June | 30 | Collins Bearing Company, 100% stock dividend; offsetting credit, Dividend Income; par value.... | | | | #CH7819 | 10,000.00 |
| | | | | | | | $271,305.00 |

CREDITS

| | | | |
|---|---|---|---|
| Mar. | 19 | 1,000 shares of Antex Company, Ctf. #6488 sold for.......................... | $ 75,000.00 |
| July | 31 | 100 shares of Collins Bearing Company, Ctf. #CH7819, sold to S. Grant Conner, president of Aerator Sales Company for a total price of $10,000.00, and on which a down payment was received of.................................. | 1,000.00 |
| | | (Balance, payable on demand.) | |
| Aug. | 1 | Fairfax Arms, Inc., $20,000.00 par value of 1st mortgage bonds redeemed at 105 plus accrued interest................................................. | 21,500.00 |
| | | | $ 97,500.00 |

The following transactions were not yet recorded:

On December 28 of the year under audit, the company took a $7,000.00, 3-year, 6%, chattel mortgage on the machinery of one of its customers, (J. E. Dykes) to settle a past due accounts receivable balance of $7,264.00. Simple interest for three years was collected in advance.

On December 31, the company purchased for cash, 100 shares of the no-par common stock of the Aerator Sales Company, Ctf. #149, at a price of 76; and $10,000.00 par value of Eastwood & Company 4½% bonds, Ctf. #101–110, due 8 years and 1 day from today, interest payable January 1 and July 1, at a price of 94.

**Required:**

Working papers for the Marketable Securities account.

## Lincoln Motor Company

The Marketable Securities account of the Lincoln Motor Company was classified by the company and its auditors as a current asset. On December 31, 19—, this account had a balance of $530,000.00; and its related valuation account a balance of $85,000.00; these were audited values. The balances of these accounts consisted of the following items:

*Marketable Securities:*

| | | | |
|---|---|---|---|
| General Stores Corporation | 500 at 74 | = | $ 37,000.00 |
| Hemmingway Tool Company | 5,000 at 28 | = | 140,000.00 |
| Hibernia Electric Company | 1,000 at 44 | = | 44,000.00 |
| Lincoln Motor Company | 1,000 at 75 | = | 75,000.00 |
| Sharpe Drug Company | 2,000 at 69 | = | 138,000.00 |
| Sherman Foundries Corporation | 1,000 at 46 | = | 46,000.00 |
| Standard Steel Corporation | 1,000 at 50 | = | 50,000.00 |
| | | | $530,000.00 |

*Reserve for Decline of Marketable Securities:*

| | *Cost* | *Market* | *Reserve* |
|---|---|---|---|
| General Stores Corporation | 74 | 80 | |
| Hemmingway Tool Company | 28 | 20 | $40,000.00 |
| Hibernia Electric Company | 44 | 41 | 3,000.00 |
| Lincoln Motor Company | 75 | 70 | 5,000.00 |
| Sharpe Drug Company | 69 | 61 | 16,000.00 |
| Sherman Foundries Corporation | 46 | 29 | 17,000.00 |
| Standard Steel Corporation | 50 | 46 | 4,000.00 |
| | | | $85,000.00 |

During the next 12 months the following transactions occurred:

| *Purchases* | *Sales* |
|---|---|
| 2,500 General Stores at 70 | 1,000 General Stores at 84 |
| 5,000 Hemmingway Tool Company at 18 | 1,000 Hemmingway Tool at 25 |
| | 1,000 Hibernia Electric at 50 |
| 9,000 Lincoln Motor Company at 70 | 5,000 Lincoln Motor at 80 |
| 3,000 Sharpe Drug Company at 55 | |
| 1,500 Sherman Foundries at 30 | 2,000 Sherman Foundries at 33 |
| 1,000 Standard Steel at 41 | 1,000 Standard Steel at 44 |
| 2,500 Taylor Instrument Company at 63 | |

For the purpose of this problem, stock purchases may be assumed to occur in the first half of the year and sales in the second half. At the end of the year, current market prices were:

| | | | |
|---|---|---|---|
| General Stores Corporation | 85 | Sharpe Drug Company | 50 |
| Hemmingway Tool Company | 25 | Sherman Foundries Corporation | 21 |
| Hibernia Electric Company | 55 | Standard Steel Corporation | 36 |
| Lincoln Motor Company | 84 | Taylor Instrument Company | 59 |

**Required:**

(1) How should the above accounts and related information be reflected in the comprehensive statement of income for the current calendar year?

(2) How should the securities on hand be valued and classified in the balance sheet of December 31, 19—? All stocks were $100.00 par.

# 7. INVENTORIES

## E. A. Finchley Company

A summary of the inventory of the E. A. Finchley Company on December 31, 19—, was:

| | *Invoice Cost* | *Market* | *Could Be Sold for* |
|---|---|---|---|
| Merchandise on hand, new and salable.............. | $108,717.00 | $108,413.00 | $183,912.00 |
| Merchandise on hand, new and salable, received on consignment.................................. | 23,411.00 | 22,010.00 | 39,604.00 |
| Merchandise on hand, new merchandise but shopworn and soiled..................................... | 4,804.00 | | 2,000.00 |
| Merchandise on hand, obsolete and out of style....... | 2,500.00 | | 500.00 |
| Merchandise on hand, new and salable—a special style lot to be sold at 10% under cost in order to make way for spring merchandise. A contract for the sale of this merchandise has been signed................. | 12,000.00 | 12,200.00 | 10,800.00 |
| Merchandise in hands of various dealers, on consignment........................................ | 18,000.00 | 17,950.00 | 30,450.00 |
| Merchandise in transit, terms f.o.b. shipping point.... | 9,612.00 | 9,612.00 | 16,260.00 |
| Merchandise in transit, terms f.o.b. destination....... | 700.00 | 700.00 | 1,167.00 |
| | $179,744.00 | $170,885.00 | $284,693.00 |

Purchases of merchandise for the year totaled $1,022,016.00. Freight paid on these purchases, amounting to $15,330.00 may be assumed to apply ratably to all merchandise.

The value of the inventory on January 1, 19—, was $164,211.00. Sales for the year were $1,742,677.00 on which the rate of gross profit generally averaged 40%.

**Required:**

(1) How would you show the inventory on the balance sheet of December 31, 19—?

(2) What would constitute the audit program for this case?

## Marmon Car and Foundry Company

The Marmon Car and Foundry Company was working on a contract calling for 210 railway cars, all of the same type. The price on these cars was fixed in the contract at $21,000.00 each.

On December 31, 19—, you find that the company had incurred costs of $2,700,000.00 on this contract, that 160 cars had been delivered to the purchaser, that 25 were in the process of construction, and 25 were yet to be built. The 25 cars in process were estimated by management to be about 80% complete.

All costs were charged to a single work order calling for the construction of 210 cars.

**Required:**

(1) At what value should the 160 cars be costed in the statement of income? At what value should the 25 cars in process be carried in the balance sheet of December 31, 19—?

(2) What are some of the important steps in the audit program for the verification of the values above?

## "Mike" Bedisien & Son

"Mike" Bedisien & Son buys used cars, wrecks them, and sells the parts separately. The business earns an annual net profit of approximately $50,000.00 before taxes.

**Required:**

For your audited financial statements for the year 19—, explain how you would verify cost of sales and the value of the ending inventory (consisting of carburetors, fly wheels, rims, and scores of other items).

## Landry Hardware Company

The accounts of the Landry Hardware Company were being audited for the year 19—. In his verification of the ending inventory, the auditor ascertained that the audited value of the beginning inventory was \$117,197.85, purchases for the year were \$385,502.92, and sales \$500,780.50. The company's average rate of markup on cost was $66\frac{2}{3}\%$.

The auditor also found that one of the sales made on December 31, 19—, was for a special contract of heavy hardware. The merchandise was invoiced to the customer at \$70,780.50, this price representing a 40% markup on cost. The terms of this invoice included a cash discount allowance of 5% for payment within ten days. Normally, invoices of the company were billed net, no discount.

**Required:**

At what value did the auditor estimate the inventory at the end of the year?

# T. H. Beck & Company

The condensed trial balances of T. H. Beck & Company on December 31, 19— were:

| | Last Year | | This Year | |
|---|---|---|---|---|
| Beginning Inventory (last year): | | | | |
| At cost | $ 20,000.00 | | | |
| At market, $30,000.00 | | | | |
| Beginning Inventory (this year) | | | $ | |
| Sundry Assets | 390,000.00 | | 355,000.00 | |
| Capital Stock, $100.00 par | | $300,000.00 | | $300,000.00 |
| Earned Surplus | | 100,000.00 | | 80,000.00 |
| Sales | | 200,000.00 | | 240,000.00 |
| Purchases | 170,000.00 | | 230,000.00 | |
| Operating Expenses | 20,000.00 | | 25,000.00 | |
| | $600,000.00 | $600,000.00 | $ | $ |

Ending inventory (last year),
at cost, $40,000.00; at market $10,000.00.

**Required:**

Complete the trial balance for this year by inserting the proper accounting valuation for inventory (with an adjustment of Earned Surplus, if necessary).

Assuming that the rates of gross profit and inventory turnover are the same this year as last year:

What is the estimated value of the inventory, at cost, at the end of this year? Prepare a condensed profit and loss statement for this year, assuming that the market value of the new inventory is $10,000.00 less than its cost.

## HPF Vegetable Oils, Inc.

You are auditing the accounts of HPF Vegetable Oils, Inc., for the calendar year 1952. You also audited the accounts for 1951. No inventory was taken on December 31, 1952, but "on the basis of careful estimates," the president of the company, Mr. H. Parker Fieselman, stated that the inventory was probably "about $38,000.00 to $42,000.00—say an average of $40,000.00"—cost being about the same as market. Prices on the company's oils were constantly adjusted to reflect changes in the major market (Atlanta) in which its supplies were obtained. Gross margin percentages were about the same from year to year and, said Mr. Fieselman, there was no change in the gross margin for 1952 "that he knew of."

The following information is assembled:

| | *1951* | *1952* |
|---|---|---|
| Sales | $240,000.00 | $250,000.00 |
| Inventory, December 31, 1950: | | |
| —at cost | 20,000.00 | |
| —at market | 30,000.00 | |
| Purchases | 170,000.00 | 177,000.00 |
| Inventory, December 31, 1951: | | |
| —at cost | 40,000.00 | |
| —at market | 10,000.00 | |
| Inventory, December 31, 1952 | | ? |
| Expenses | 60,000.00 | 61,750.00 |

**Required:**

Prepare your preliminary condensed statement of profit and loss for the year 1952. Does this statement raise any questions in your mind as to the value of $40,000.00 placed on the new inventory? Explain.

## Modern Store For Men, Inc.

The profit and loss statement of the Modern Store for Men, Inc., for the past calendar year has been completed (except for the ending inventory) as follows:

| | | |
|---|---|---|
| Sales | | $287,506.00 |
| Cost of Sales: | | |
| Inventory, December 31, 19— | $ 80,010.00 | |
| Purchases | 243,050.00 | |
| Freight In | 12,152.50 | |
| | $335,212.50 | |
| Inventory, December 31, 19— | ? | ? |
| Gross Profit | | $ ? |
| Operating Expenses | | 23,011.00 |
| Net Profit (Before Income Taxes) | | $ ? |

The new inventory appeared on the inventory sheet as follows:

| | *Quantity* | *Invoice Price per Unit* | *Current Market Price per Unit* |
|---|---|---|---|
| Overcoats | 410 | $ 30.00 | $33.00 |
| Topcoats | 372 | 27.00 | 25.00 |
| Spring topcoats, in transit, f.o.b. shipping point (not recorded in Purchases account) | 100 | 29.90 | 29.90 |
| Men's suits | 1,068 | 34.00 | 29.00 |
| Robes | 101 | 11.00 | 7.00 |
| Shirts | 91⅔ doz. | 1.93 | 2.10 |
| Neckties | 60 doz. | 1.00 | 1.05 |
| Hats | 20 doz. | 8.00 | 5.50 |
| Hosiery | 500 pr. | .66 pr. | .60 pr. |
| Cash register | 2 | 150.00 | 75.00 |
| Shoes | 450 pr. | 7.00 pr. | 6.00 pr. |
| Display racks | 17 | 180.00 | 80.00 |

**Required:**

(1) Complete the profit and loss statement in the form that it would appear in your audit report. The beginning inventory is valued correctly, as per your audit report of the previous year.

(2) List the steps which should be included in the audit program for the verification of the above inventory.

## The New Colonial Company

The New Colonial Company was a distributor of agricultural equipment. Some sales were made on a sight-draft-order-bill-of-lading basis; other sales were made through units shipped to dealers on a consignment basis. The equipment had a cost of $650.00 per unit and was uniformly invoiced to purchasers and consignees alike at $1,200.00 per unit. Consignees remitted $1,200.00 for each of the units they sold. Last year the amount of cash received from consignees was $3,391,200.00. At the end of the year, their reports showed that 23 of the consignment units were unsold.

You are examining last year's tentative profit and loss statement which is as follows:

**THE NEW COLONIAL COMPANY**

PROFIT AND LOSS STATEMENT FOR THE YEAR 19—

| | Units | | |
|---|---|---|---|
| Sales | | | $6,180,000.00 |
| Cost of Sales: | | | |
| Inventory, January 1, 19— | 1,510 | | |
| Purchases | 4,454 | | |
| | 5,964 | | |
| Inventory, December 31, 19— | 814 | | |
| | 5,150 | at $650.00 = | $3,347,500.00 |
| Representing: | | | |
| Shipments to purchasers | 3,008 | | |
| Shipments to consignees | 2,142 | | |
| | 5,150 | | |
| Gross Profit | | | $2,832,500.00 |
| Selling and General Expenses | | | 2,017,500.00 |
| Net Profit | | | $ 815,000.00 |

**Required:**

(1) Would you approve this statement as correct? If not, prepare a true statement.

(2) What adjusting entries, if any, would you recommend if the books have not been closed? If the books have been closed?

## Banks-Moody Corporation

The tentative, condensed, profit and loss statement of the Banks-Moody Corporation for the calendar year 19— was substantially as follows:

| | | |
|---|---|---|
| Sales | | $40,000,000.00 |
| Cost of Sales: | | |
| Inventory, December 31, 19— | $ 3,900,000.00 | |
| Purchases | 20,000,000.00 | |
| Freight In | 1,000,000.00 | |
| Insurance Expense | 100,000.00 | |
| | $25,000,000.00 | |
| Inventory, December 31, 19— | 2,000,000.00 | 23,000,000.00 |
| Gross Profit | | $17,000,000.00 |
| Selling and General Expenses | | 12,340,000.00 |
| | | $ 4,660,000.00 |
| *Add* Purchases Discounts Taken | | 340,000.00 |
| Net Profit | | $ 5,000,000.00 |

The beginning inventory is correct, as per audited values of one year ago. The ending inventory, you find, is valued at cost (which also approximates current market); cost represents invoice costs, not inclusive of freight, insurance, or cash discounts (approximately 2%). Accounts payable, as of December 31, were all current and subject to cash discount. The new inventory was taken by proper inventory methods. The inventory sheets included all merchandise actually received through December 31, 19—.

Upon your examination of the voucher register, you find twelve recorded invoices of particular interest as follows:

| *Voucher Register Month of:* | *Date of Invoice* | *Merchandise Received* | *F. O. B. Destination* | *F. O. B. Shipping Point* | *Amount* |
|---|---|---|---|---|---|
| December | Dec. 21 | Dec. 23 | x | | $13,000 |
| | 22 | Jan. 3 | x | | 31,000 |
| | 23 | Dec. 30 | | x | 2,000 |
| January | Dec. 29 | Jan. 5 | | x | 9,000 |
| | Jan. 3 | Dec. 29 | x | | 6,000 |
| | Dec. 27 | Dec. 31 | | x | 22,000 |
| | Dec. 29 | Jan. 5 | x | | 2,000 |
| | 30 | Dec. 31 | x | | 7,000 |
| | Jan. 28 | Dec. 30 | | x | 12,000 |
| | 2 | Dec. 30 | | x | 10,000 |
| | Dec. 28 | Jan. 5 | | x | 30,000 |
| | 29 | Jan. 6 | x | | 10,000 |

**Required:**

(1) Prepare working papers showing your revaluation, if any, of the new inventory.

(2) Prepare a corrected profit and loss statement for the year.

## Seneca Lakes Marine Sales Company

The Seneca Lakes Marine Sales Company began business on March 1, 19— with no inventory. At the end of four months of operations, certain ledger accounts were as follows:

PURCHASES

| | | | | |
|---|---|---|---|---|
| Mar. | 3 | 1 cruiser | 12,000.00 | |
| | 10 | 2 snipes | 1,300.00 | |
| | 12 | 10 canoes | 1,490.00 | |
| Apr. | 9 | 10 motors | 2,100.00 | |
| May | 15 | 1 cruiser | 7,800.00 | |
| | 29 | 10 outboards | 2,800.00 | |
| June | 1 | 3 runabouts | 7,200.00 | |
| | 30 | 1 cruiser | 11,500.00 | |

SALES

| | | | | |
|---|---|---|---|---|
| | Mar. | 20 | 2 canoes | 400.00 |
| | Apr. | 1 | 1 cruiser | 15,000.00 |
| | | 11 | 1 snipe | 900.00 |
| | | 22 | 4 canoes | 850.00 |
| | | 29 | 2 motors | 720.00 |
| | May | 3 | 1 motor | 470.00 |
| | | 12 | 1 snipe | 875.00 |
| | June | 1 | 1 cruiser | 6,500.00 |
| | | 27 | 5 outboards | 1,900.00 |
| | | 20 | 1 runabout | 3,200.00 |

FREIGHT IN

| | | | |
|---|---|---|---|
| Mar. | 3 | 920.00 | |
| | 10 | 110.00 | |
| | 12 | 150.00 | |
| Apr. | 9 | 200.00 | |
| May | 15 | 700.00 | |
| | 29 | 220.00 | |
| June | 1 | 600.00 | |
| | 30 | 900.00 | |

All purchases were received freight collect.

The cruiser purchased on May 15 was sold on June 1 for $10,300.00 less an allowance of $3,800.00 for a used cruiser accepted as a trade-in. The used cruiser was sold on July 7 for $3,600.00.

The average rate of gross profit realized on sales was: canoes, 30%; motors, 25%; runabouts, 28%; and outboards, 35%.

**Required:**

What was the cost value of the inventory on June 30, 19—? What was the cost of sales for the four months ending June 30, 19—? Show your computations on working papers.

## Haggerty Manufacturing Company

The chief accountant of the Haggerty Manufacturing Company gives you his tentative profit and loss statement for the calendar year of 19— which you are auditing:

| | | | | |
|---|---|---|---|---|
| Sales | | | | $1,000,000.00 |
| Cost of Sales: | | | | |
| Finished Goods, Dec. 31 (last year) | | | $ none | |
| Finished Goods Manufactured in 19—: | | | | |
| Work in Process, Dec. 31 (last year) | | $103,383.45 | | |
| Raw Materials Consumed: | | | | |
| Raw Materials, Dec. 31 (last year) | $ 93,984.95 | | | |
| Purchases | 394,736.79 | | | |
| | $488,721.74 | | | |
| Raw Materials, Dec. 31 (this year) | 75,187.96 | 413,533.78 | | |
| Direct Labor | | 225,563.88 | | |
| Manufacturing Expenses | | 234,962.37 | | |
| | | $977,443.48 | | |
| Work in Process, Dec. 31 (this year) | | 244,360.87 | 733,082.61 | |
| | | | $733,082.61 | |
| Finished Goods, Dec. 31 (this year) | | | 146,616.52 | 586,466.09 |
| Gross Profit | | | | $ 413,533.91 |
| Selling Expenses | | | $187,969.90 | |
| General Expenses | | | 93,985.08 | 281,954.98 |
| Net Profit | | | | $ 131,578.93 |

Beginning inventories in this statement were audited values taken from the audit report of the preceding year. The ending inventories were valued as follows: finished goods, 20% × $733,082.61 = $146,616.52; work in process, 25% × $977,443.48 = $244,360.87; raw materials, at cost, $112,781.94, and at market, $75,187.96. The percentages of 20% and 25%, representing the quantity of the year's production still on hand, may be accepted as correct.

**Required:**

Prepare a corrected profit and loss statement incorporating whatever changes are relevant.

## L & L Stores, Inc.

The condensed trial balance of the L & L Stores, Inc., on December 31, 19— was:

| | | |
|---|---|---|
| Cash | $ 350,000.00 | |
| Accounts Receivable | 650,000.00 | |
| Finished Goods | 100,000.00 | |
| Work in Process | 50,000.00 | |
| Raw Materials | 60,000.00 | |
| Fixed Assets (control) | 700,000.00 | |
| Reserve for Depreciation | | $ 200,000.00 |
| Warehouse Under Construction (materials, $50,000.00; labor, $75,000.00) | 125,000.00 | |
| Accounts Payable | | 200,000.00 |
| Capital Stock, $100.00 par | | 1,000,000.00 |
| Earned Surplus | | 525,000.00 |
| Sales | | 1,600,000.00 |
| Purchases of Raw Materials | 300,000.00 | |
| Direct Labor | 500,000.00 | |
| Indirect Labor | 150,000.00 | |
| Depreciation Expense—Factory | 50,000.00 | |
| Repairs and Maintenance—Factory | 25,000.00 | |
| Miscellaneous Factory Expense | 125,000.00 | |
| Selling Expenses | 215,000.00 | |
| General Expenses | 125,000.00 | |
| | $3,525,000.00 | $3,525,000.00 |

As shown by the trial balance, the company had undertaken the construction of a warehouse for its own use. This construction was finished as of the date of the above trial balance. It was proper, therefore, to close the Warehouse-Under-Construction account and to debit the new warehouse to the Fixed Assets account at a proper value. Officials of the company estimated that the manufacturing overhead of the company had increased about $25,000.00 as the result of the construction; this increase, however, was temporary and applied only to the period of construction.

At the end of the year the new inventories were valued as follows:

| | *Materials* | *Labor* | *Overhead* | *Total* |
|---|---|---|---|---|
| Raw materials | $50,000.00 | | | $50,000.00 |
| Work in process | 15,000.00 | $10,000.00 | ? | ? |
| Finished goods | 50,000.00 | 40,000.00 | ? | ? |

**Required:**

(1) What is the cost of the new warehouse?

(2) Profit and loss statement for the year.

(3) Balance sheet, December 31, 19—.

## Institute Wineries, Inc.*

With respect to the company's inventory of wine on hand, you have the following information:

(1) The average cost of grape juice was $1.55 per gallon.

(2) The average cost of brandy, of which 5 gallons were used per 50-gallon barrel of finished wine, was $3.75 per gallon.

(3) Filtration loss was about 4 gallons to each 50 gallons. (The federal government allows 6%.)

(4) The total labor cost to produce 40,000 gallons annually was $18,000.00.

(5) The cost of a 50-gallon barrel was $5.50.

(6) Plant overhead was about one third of the labor cost.

(7) Shrinkage averaged about 1% per annum.

(8) Carrying charges averaged about 6% per annum.

(9) Of the 20,000 gallons of wine on hand, 5,000 gallons were 15 years old, and 15,000 gallons were 6 years old.

**Required:**

(1) What values should be placed on the inventories? Show your computations.

(2) What would be your audit program for the verification of these inventories?

## Federal Steel Company*

The Dayton Manufacturing Company makes ferro-chrome at a cost of $254.00 a ton; and the Easton Manufacturing Company makes spiegeleisen (ferro manganese) at a cost of $142.00 a ton. These products are sold to the Federal Steel Company (a controlling corporation) at prices of $320.00 and $180.00 a ton, respectively. Using the products of these companies, the Federal Steel Company makes steel, some being Bessemer steel and some open-hearth chrome steel.

Manufacturing statistics of the Federal Steel Company were:

| | *Bessemer* | *Chrome Steel* |
|---|---|---|
| Materials: | | |
| Pig | 105 tons | 65 tons |
| Spiegeleisen | 6 " | |
| Scrap | | 20 " |
| Ore | | 10 " |
| Ferro-chrome | | 15 " |
| | 111 " | 110 " |
| Loss of weight in manufacturing | 11 " | 10 " |
| Tons of ingots produced | 100 tons | 100 tons |

In the conversion of ingots into shapes there is a further loss of 10% of the weight of the ingots.

The current inventory of the Federal Steel Company consists of:

| | | | |
|---|---|---|---|
| Spiegeleisen | 370 tons | Bessemer shapes | 9,000 tons |
| Ferro-chrome | 1,200 tons | Chrome steel ingots | 46,000 tons |
| Bessemer ingots | 23,000 tons | Chrome steel shapes | 18,000 tons |

The inventories of three companies, before adjustment, are:

| | |
|---|---|
| Dayton Manufacturing Company | $ 240,000.00 |
| Easton Manufacturing Company | 630,000.00 |
| Federal Steel Company | 14,660,000.00 |
| | $15,530,000.00 |

**Required:**

What is the cost value of the consolidated inventory after eliminating 100% of intercompany profits?

## The Excel Corporation

The identity of the manufacturing unit of the Excel Corporation is maintained throughout the manufacturing processes of the company—from raw material to finished product. A substantial part of the manufacturing process is "assembly" in character. At the close of operations for the past calendar year, the following information is assembled:

| | *Units* | *Cost* |
|---|---|---|
| Sales | 225,000 | $20,000,000.00 |
| Inventories at beginning of year: | | |
| Finished goods | none | |
| Work in process | none | |
| Raw materials | 22,500 | $ 450,000.00 |
| Purchases of materials: | | |
| January–March | 50,000 | 1,200,000.00 |
| April–June | 67,500 | 1,485,000.00 |
| July–September | 87,500 | 1,575,000.00 |
| October–December | 70,000 | 1,400,000.00 |
| Direct Labor | | 4,077,200.00 |
| Manufacturing expenses | | 2,800,000.00 |
| Inventories at end of year: | | |
| Finished goods | 25,000 | |
| Work in process (100% complete as to raw materials content, and 60% complete as to all other manufacturing costs) | 17,500 | |
| Raw materials (market price, $18.80 per unit) | 30,000 | |
| Selling expense | | 4,000,000.00 |
| General expenses | | 3,416,000.00 |

At the close of the calendar year, the company held unfilled contracts for the sale of units as follows: 250 units at $100.00; 1,250 units at $92.00; and 3,500 units at $88.00.

**Required:**

(1) Prepare the profit and loss statement for the year 19—.

(2) How should the inventories be valued and shown in the balance sheet of December 31, 19—?

## Company P

On January 1, 1943, Company P acquired 80% of the common stock of Company Y; on January 1, 1953, it acquired 90% of the common stock of Company Z; and on December 31, 1955, it acquired 75% of the common stock of Company X.

On December 31, 1955, the inventories of the four companies were:

| | *Inventory at Invoice cost* | Amount of Intercompany Profit Made by | | | |
|---|---|---|---|---|---|
| | | *Company P* | *Company X* | *Company Y* | *Company Z* |
| Company P | $500,000.00 | | $25,000.00 | $50,000.00 | $60,000.00 |
| Company X | 300,000.00 | | | | 50,000.00 |
| Company Y | 250,000.00 | $30,000.00 | | | 45,000.00 |
| Company Z | 200,000.00 | 25,000.00 | | 40,000.00 | |

On January 1, 1948, Company Y erected a building for Company P at a price of $600,000.00 (construction cost, $500,000.00; estimated annual depreciation rate, 3%).

**Required:**

(1) At what value should the inventory and the building appear in the consolidated balance sheet of Company P?

(2) What steps should be included in the audit program for the verification of the values to appear in the financial statements?

## The Carey Products Company

The Carey Products Company was a large importing and manufacturing company in New Orleans. The company imported all raw materials and, because of the following circumstances, found it necessary to carry a large inventory, continuously—the usual inventory on hand being sufficient to care for manufacturing needs for six months or more, and carrying a value of approximately $1,500,000.00 (cost).

(1) The imported materials were by-products of a certain fruit industry and, therefore, they were principally available at certain seasons of the year.

(2) The company desired to follow a reasonably smooth production program over a 12-months' period because (a) the demand for the finished product was reasonably steady throughout the year, and (b) marked production economies were realizable through a steady manufacturing program. When manufacturing schedules were not steady, unit costs were much higher.

(3) Since the purity content of the imported materials varied considerably, the company used a great deal of care in grading and preparing its raw materials for manufacture. This contributed significantly to the need for carrying a large inventory.

The valuation of the company's inventory was often the subject of discussion between officials and auditors of the company. While ordinary business and accounting practices dictated observance of the rule of "cost or market, whichever is lower," it was thought that this rule might not be applicable to the inventory of the Carey Products Company even though current market prices were about 10% under the company's unit purchase cost of its inventory.

The inventory problem of the company was also complicated by the following factors:

(1) The company was the principal importer of the raw materials in question and it was therefore the dominant factor in establishing their price.

(2) Should the company attempt to purchase only a small supply of these raw materials on the local or New York market, prices would rise rapidly, so close was the relation between supply and demand.

(3) Reasonable prices for its imports were realizable by the company because it carried a large inventory and because, also, its purchasing agents were resident in the exporting country.

(4) Under ordinary circumstances, the company was not likely to sustain a loss on the realization of its inventory because:

(a) The lack of an open market for the raw materials in question made it impossible for any one to buy or control sufficient raw materials to undersell the Carey Products Company.

(b) The market for the finished product was steady and profitable.

(5) Since the close of the company's fiscal year came during the off-season for these raw materials:

(a) Current, reliable quotations were difficult to obtain.

(b) Any quotations that might be obtained would not be likely to represent any appreciable supply.

**Required:**

(1) Would this company be justified in regularly departing from the rule of "cost or market, whichever is lower?"

(2) How should the company value its inventories of raw materials, work in process, and finished goods, in so far as the raw material content of these inventories is concerned? Explain carefully.

## Leonard Candy Company

As part of your program for the audit of the Leonard Candy Company for the past calendar year, the following perpetual inventory card for "sugar" was examined:

| | Quantities | | | | Dollars | | |
|---|---|---|---|---|---|---|---|
| | *Bought* | *Consumed* | *Balance* | *Price* | *Bought* | *Consumed* | *Balance* |
| Balance.... | | | 100,000 | | | | 5,000.00 |
| January.... | 110,000 | | | $0.0500 | 5,500.00 | | |
| | | 90,000 | | | | 4,500.00 | |
| | | | 120,000 | | | | 6,000.00 |
| February... | 100,000 | | | .0525 | 5,250.00 | | |
| | | 80,000 | | | | 4,000.00 | |
| | | | 140,000 | | | | 7,250.00 |
| March...... | 105,000 | | | .0500 | 5,250.00 | | |
| | | 90,000 | | | | 4,625.00 | |
| | | | 155,000 | | | | 7,875.00 |
| April....... | 100,000 | | | .055 | 5,500.00 | | |
| | | 105,000 | | | | 5,375.00 | |
| | | | 150,000 | | | | 8,000.00 |
| May....... | 100,000 | | | .056 | 5,600.00 | | |
| | | 75,000 | | | | 3,875.00 | |
| | | | 175,000 | | | | 9,725.00 |
| June....... | | | | | | | |
| | | 45,000 | | | | 2,475.00 | |
| | | | 130,000 | | | | 7,250.00 |
| July........ | 90,000 | | | .0575 | 5,175.00 | | |
| | | 95,000 | | | | 5,290.00 | |
| | | | 125,000 | | | | 7,135.00 |
| August..... | 80,000 | | | .06 | 4,800.00 | | |
| | | 70,000 | | | | 4,200.00 | |
| | | | 135,000 | | | | 7,735.00 |
| September.. | 75,000 | | | .0625 | 4,687.50 | | |
| | | 80,000 | | | | 4,987.50 | |
| | | | 130,000 | | | | 7,435.00 |
| October.... | 100,000 | | | .065 | 6,500.00 | | |
| | | 90,000 | | | | 5,850.00 | |
| | | | 140,000 | | | | 8,085.00 |
| November.. | 110,000 | | | .0625 | 6,875.00 | | |
| | | 100,000 | | | | 6,250.00 | |
| | | | 150,000 | | | | 8,710.00 |
| December... | 60,000 | | | .06 | 3,600.00 | | |
| | | 40,000 | | | | 2,400.00 | |
| | | | 170,000 | | | | 9,910.00 |

**Required:**

(1) What explanation might account for a difference between the physical and book inventory of sugar? If there is a difference, what is the auditor's adjusting entry?

(2) What constitutes proper "auditing" of the inventory of sugar? Is the ending value of $9,910.00 satisfactory? If not, what entry should be placed on the working papers?

(3) If the quantity of sugar on hand December 31, 19—, were correct, and if the current market price on sugar was 6½¢, what bearing would this price have on the auditor's valuation of inventory? If the price were 4 cents?

(4) If the quantity of sugar on hand at the end of the year had been 1,170,000 lb. instead of 170,000 lb., would you raise any question regarding the size or quality of the inventory? Why? Would your answers have been the same if the commodity had been chocolate, shelled nuts, or gelatin? Why?

## Mexical Furniture Company

The Mexical Furniture Company operated a retail store in a city of Southern California. One of the company's inventory sheets of December 31, 19—, is being examined by one of the members of your audit staff. In substance, the inventory sheet was as follows:

**MEXENE PEEL OUTDOOR FURNITURE** #89

| | | | | | | | AUDITOR'S REMARKS | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | *Inventory* | | *Last Purchase* | |
| | | | | | *Current* | *at lower* | *Last* | | |
| *Item* | *Description* | *Quantity* | *Cost* | *Amount* | *Market* | *of C or M* | *Sale* | *Date* | *Price* |
| 1200 | Settee, seat 18" x 43" height, 32" | 37 | $12.00 | $ 444.00 | $12.00 | | 12/29 | 12/12 | $12.00 |
| 1201 | Coffee Table, top, 24" x 16", height, 18" | 12 | 6.00 | 72.00 | 5.00 | | 9/16 | 7/9 | 6.00 |
| 1202 | Nests of 4 tables from 14" square x 19" high to 27" x 30" | 49 | 30.00 | 1,470.00 | 21.00 | | 8/17 | 1/4 | 30.00 |
| 1203 | Fan Back Arm Chair, seat, 19" x 19", height, 39" | 21 | 8.50 | 178.50 | 9.00 | | 12/10 | 11/28 | 8.50 |
| 1204 | Square Back Arm Chair, 18" x 18", 29" high | 7 | 5.00 | 35.00 | 6.00 | | 12/30 | 12/3 | 5.00 |
| 1205 | Rocker Chair | 18 | 9.50 | 171.00 | 9.75 | | 12/16 | 12/1 | 9.50 |
| 1206 | Arm Chair, 18" x 18", 35" high | 26 | 7.00 | 182.00 | 7.00 | | 12/29 | 11/21 | 7.00 |
| 1207 | End Table, with magazine racks | 139 | 6.00 | 834.00 | 6.00 | | 7/14 | 1/4 | 6.00 |
| 1208 | Magazine Racks | 30 | 4.00 | 120.00 | 3.00 | | None | 1/4 | 4.00 |
| | | | | $3,506.50 | | | | | |

The unit prices do not include transportation-in charges of approximately 10% additional nor import duties and insurance of approximately 5% each.

**Required:**

(1) What would be a proper audit program for the examination of this inventory sheet? Should this procedure apply to all inventory sheets? Discuss.

(2) Should transportation, import duties, insurance, and warehousing costs be added to unit prices? Discuss.

(3) What is the value of the inventory on sheet #89, at cost? At the lower of cost or market?

(4) What is the significance, if any, of the "auditor's remarks" on the inventory sheet? Is the inventory sheet organized properly?

## Van De Bilt's Fifth Avenue

The following items represent a segment of the inventory of Van De Bilt's Fifth Avenue on February 28, 19—, the last day of the company's fiscal year:

| | | *Marked Retail Price per Item* | *March "Sale" Price* |
|---|---|---|---|
| 9 | Linen bridge sets, pastels, hand-embroidered | $ 17.95 | $ 8.89 |
| 61 | Filet lace scarves, 45" length, handmade | 5.68 | 1.98 |
| 16 | Cocktail napkins, hand-embroidered, sets of 8 | 9.85 | 4.98 |
| 4 | Luncheon sets, 17 pc. rayon damask | 14.95 | 6.98 |
| 12 | Pillow cases, hand-embroidered | 5.95 pr. | 3.49 |
| 182 | Guest towels, pure linen, embroidered | 1.95 | .89 |
| 91 | Pure linen guest towels, elaborately hand-embroidered | 4.95 | 2.69 |
| | Spun rayon printed sets: | | |
| 26 | 54" x 54", 4 napkins | 7.95 | 4.88 |
| 57 | 63" x 81", 8 napkins | 19.85 | 12.88 |
| | Chenille bath rug and lid sets, by Carter, | | |
| 7 | sizes 20" x 36" | 14.95 | 7.98 |
| 30 | sizes 24" x 48" | 22.50 | |
| 84 | Cannon bath mats, pastels | 3.95 | 1.89 |
| 16 | Quilt covers, dotted Swiss, slip-in type | 11.95 | 5.98 |
| 91 | St. Mary's blankets, 100% virgin wool | 18.95 | 12.98 |
| 141 | St. Mary's blankets, 100% virgin wool | 15.95 | 9.98 |
| 23 | Satin comforts, hand-stitched | 45.00 | 29.88 |
| 5 | Velvet comforts, exquisitely hand-stitched | 95.00 | 49.88 |
| 14 | Satin covered pillows, white goose down filled | 11.95 | 6.98 |
| 24 | Blanket covers, rayon crepes, smartly trimmed | 21.85 | 11.98 |
| 112 | Cannon bath towels, white | 1.95 | .96 |
| 37 | 6 pc. bath towel sets, novelty embroidery | 19.85 | 9.88 |
| 284 | Luncheon cloths, pure linen, 52" x 52", wine and royal blue | 4.95 | 1.97 |
| 2 | 17 pc. luncheon sets, smart Swiss embroidered organdy | 45.00 | 19.95 |
| 6 | 17 pc. linen luncheon sets, elaborately hand-embroidered | 54.50 | 24.95 |
| 8 | 17 pc. linen luncheon sets, smartly embroidered | 26.00 | 13.95 |
| 14 | 17 pc. linen luncheon sets, pastels with hemstitched or embroidered card effects | 21.00 | 10.98 |
| 32 | 9 pc. luncheon sets, novelty linen weave | 16.95 | 8.95 |
| 34 | 17 pc. linen luncheon sets, novelty weave, smart corded effect | 32.50 | 16.95 |
| 10 | 17 pc. organdy and linen hand-embroidered formal luncheon sets | 89.50 | 42.88 |
| 6 | Ditto | 225.00 | 98.75 |
| 11 | Bisso linen bridge sets, hand-embroidered | 14.95 | 7.89 |
| 1 | Lace dinner cloth, very fine, handmade, 3 yards | 195.00 | 79.50 |
| 93 | Rayon damask dinner sets, 64" x 84" and 8 napkins | 16.95 | 8.89 |
| 17 | Imported rayon dinner sets, 64" x 84", and 8 napkins | 49.95 | 24.95 |
| 8 | Irish linen damask dinner sets, white, 3½ yards, 12 napkins | 85.00 | 39.85 |
| 423 | Colored percale pillow cases | 1.25 | .69 |
| 231 | Colored percale sheets, 72" x 108" | 4.50 | 2.98 |
| 1627 | Percale pillow cases, white | .89 | .59 |
| 38 | All wool satin comforts | 24.95 | 12.98 |
| 8 | Dinner sets, Spanish hand-embroidered, 2½ yards, 8 napkins | 69.50 | 33.85 |
| 12 | Dinner sets, Spanish hand-embroidered, 4 yards, 12 napkins | 395.00 | 188.50 |
| 17 | Organdy and linen dinner sets, 4 yards, appliquéd, hand-embroidered | 495.00 | 229.50 |
| 3 | Linen dinner sets, hand-appliquéd, 3 yards, 12 napkins | 225.00 | 98.75 |

The first price column represents the prices at which the items were marked to sell. In March, following the close of its fiscal year, the company launched a "spring sale" in which prices on many items were reduced drastically; the special prices of this sale are shown in the second price column.

This column was added to the inventory sheets by one of the junior members of the auditor's staff.

The company operated under the retail method of inventory and its gross margin in the department above was 48%.

**Required:**

(1) Complete the inventory at retail; then reduce it to cost.

(2) What is the effect of the second price column on the auditor's valuation of inventory?

(3) What are some of the main steps to be followed in the audit program for this inventory?

## Providence Bookstore

The Providence Bookstore was a large retail store serving the student body of Providence University and residents of Providence City. Auditors were examining the accounts of the bookstore for the fiscal year ending December 31, 19—. The inventory, which was taken on December 31, 19—, was written up on 141 pages of inventory forms. The following three pages are excerpts:

MEDICAL SUPPLIES

| | | *Price* | | |
|---|---|---|---|---|
| *Quantity* | | *Retail* | *Cost* | *Inventory* |
| 1 | Dark Field Illuminators—Spencer Lens | $3.00 | $1.75 | $ 1.75 |
| 49 gr. | Gold Seal Muiro Sticks A 1450 | 2.00 | .90 | 44.10 |
| 66 | Ford Stethoscope | 3.50 | 3.00 | 198.00 |
| 2 | Diaphragmatic Stethoscope | 4.00 | 2.60 | 5.20 |
| 22 | Anatomical Dissecting Sets | 8.50 | 6.40 | 140.80 |
| 8 dz. | Bandage Shears B 825 | 1.40 ea. | 1.00 | 9.60 |
| 9¼ dz. | Steel Scissors A 1996 | 1.25 ea. | .75 | 8.33 |
| 40 | Haemostatic Forceps 6" | 2.50 | 1.25 | 50.00 |
| 65 | Haemostatic Forceps 4" | 2.25 | 1.15 | 74.75 |
| 13 | Tuning Fork C 128 | 2.50 | 1.50 | 19.50 |
| 54 | Magnifying Glass D 7150 Dietzgen | 1.00 | .65 | 35.10 |
| 4 | Tripod Magnifying Glasses | 1.00 | .65 | 2.60 |
| 16 | Stethoscope Bell Tips | 1.00 | .65 | 10.40 |
| 31 dz. | Watch Crystals | .40 dz. | .27 | 8.37 |
| 1 | Bandage Shears | 1.40 | 1.00 | 1.00 |
| 18¾ dz. | Culture Slide Center Convex | 1.00 dz. | .65 | 12.14 |
| 51 | Scalpels | .35 | .22 | 21.22 |
| 50 | Stethoscope Ear Sets | .25 | .18 | 9.00 |
| 87 | Probes | .50 | .33 | 28.71 |
| 88 | Pipettes—100 graduated | .50 | .30 | 26.40 |
| 78 | Platinum Loops | 1.25 | .60 | 48.60 |
| 6 | Thalmoscope Bulbs | 1.25 | .80 | 4.80 |
| 36 | Biology Scalpels | .35 | .22 | 7.92 |
| 57 | Thermometers | 1.00 | .50 | 57.00 |
| 289 | White Medical Gowns | 2.75 | 1.90 | 549.10 |
| 180 | Tan Medical Gowns | 3.75 | 2.77 | 518.40 |
| | | | | $1892.79 |

SUNDRY SUPPLIES

| Quantity | | Price Retail | Price Cost | Inventory |
|---|---|---|---|---|
| 67 | Script Ink | $0.25 | $0.1625 | $ 10.89 |
| 70 | Carter's Rytoff | 0.40 | 0.26 | 18.20 |
| 60 | Carter's Ink | 0.15 | 0.0975 | 58.50 |
| 35 | Higgin's Ink | 0.40 | 0.26 | 9.10 |
| 24 | Mucilage | 0.15 | 0.0975 | 23.40 |
| 30 | School Paste | 0.12 | 0.078 | 2.34 |
| 72 | Crescent Sheet Holders | 0.75 | 0.4875 | 35.10 |
| 300 | Brief Covers | 0.10 | 0.065 | 195.00 |
| 269 | Favorite Grip Covers | 0.10 | 0.06 | 16.14 |
| 90 | Challenge Spring Binders | 0.75 | 0.4875 | 43.88 |
| 104 | Round Slide Rules | 1.25 | 1.00 | 104.00 |
| 315 | Note Book 5″ x 8″ | 0.10 | 0.065 | 2.05 |
| 60 | Receipt Books | 0.10 | 0.065 | 4.23 |
| 218 | Ring Binders | 0.50 | 0.325 | 70.85 |
| 779 | Mimeo. Fillers 8½″ x 11″ | 0.10 | 0.065 | 5.06 |
| 1591 | Drawing Papers 8½″ x 11″ | 0.10 | 0.065 | 103.42 |
| 32 rm. | American Bond Typewriter Paper (12 pk. to rm.) | 0.10 ea. | 0.0625 pk. | 24.00 |
| 147 pk. | Onion Skin Paper 8½″ x 14″ | 0.75 | 0.4875 | 71.66 |
| 20 pk. | Onion Skin Paper 8½″ x 11″ | 0.40 | 0.26 | 5.20 |
| 151 | Typewriter Tablets | 0.25 | 0.1625 | 24.54 |
| 700 | Buff Drawing Papers 19″ x 24″ | 0.05 | 0.038 | 2.66 |
| 93 rm. | Cross Section Paper | 2.00 | 1.60 rm. | 168.80 |
| 578 | Erasing Shields | 0.25 | 0.1625 | 9.33 |
| 21 pk. | Kool Cigarettes | 0.19 | 0.176 | 3.70 |
| 13 pk. | Phillip Morris | 0.19 | 0.176 | 2.29 |
| 23 ctn. | Camels (10 to a carton) | 1.96 | 0.176 | 4.05 |
| 10 ctn. | Old Gold " | 1.96 | 0.176 | 1.76 |
| 29 ctn. | Chesterfield | 1.96 | 0.176 | 5.10 |
| | | | | $1025.25 |

BOOKS

| Quantity | | Price Retail | Price Cost | Inventory |
|---|---|---|---|---|
| 269 | Webster's Collegiate Dictionary | $4.00 | $2.40 | $ 645.60 |
| 67 | Economics Principles and Problems—Spahr | 5.00 | 4.00 | 268.00 |
| 81 | Writer's Guide and Index to English | 1.95 | 1.56 | 126.36 |
| 95 | Short History American Democracy | 4.00 | 3.20 | 304.00 |
| 16 | Internal Combustion Engines | 4.50 | 3.60 | 57.60 |
| 102 | World Wars and Revolutions | 3.50 | 2.80 | 285.60 |
| 225 | General Chemistry for Colleges | 4.25 | 3.40 | 765.00 |
| 7 | Statistics for Sociologists | 4.00 | 3.20 | 1280.00 |
| 15 | Industrial Purchasing | 4.25 | 3.40 | 1445.00 |
| 47 | Anthology of English Literature | 2.90 | 2.33 | 1109.51 |
| 1 | Readings in Mediaeval German | 2.50 | 2.00 | 2.00 |
| 25 | Thermodynamic Properties of Steam | 2.75 | 2.20 | 55.00 |
| 16 | Elementary Statistical Methods | 4.00 | 3.20 | 51.20 |
| 6 | Experimental Psychology | 4.00 | 3.20 | 19.20 |
| 1 | Psychology | 3.00 | 2.40 | 2.40 |
| 31 | Psychology | 2.85 | 2.28 | 70.68 |
| 6 | Newspaper Reporting | 3.00 | 2.40 | 14.40 |
| 20 | Outlines of Physical Chemistry | 3.75 | 3.00 | 600.00 |
| 6 | Systematic Organization | 2.75 | 2.20 | 13.20 |
| 46 | Problems of Thinking | 4.25 | 3.40 | 156.40 |
| 28 | Applied Business | 4.00 | 3.20 | 89.60 |
| 42 | Manufacturing Processes | 4.50 | 3.60 | 151.20 |
| 116 | Introduction to Quantitative Chemistry | 2.75 | 2.20 | 255.20 |
| 18 | Business Reports | 3.50 | 2.80 | 50.40 |
| 44 | Power Plant Testing | 5.00 | 4.00 | 1076.00 |
| 63 | Mechanism | 2.75 | 2.20 | 138.60 |
| 51 | Organic Chemistry | 3.50 | 2.80 | 142.80 |
| | | | | $9174.95 |

**Required:**

(1) Examine these inventory sheets and report your findings.

## Revere Copper and Brass, Inc.

One of the major topics at hearings of the Securities and Exchange Commission in 1939, was the accountant's responsibility for inventories. One of the expert witnesses was Mr. C. Oliver Wellington, of Scovell, Wellington & Company. The following excerpts are taken from the testimony of Mr. Wellington.

Our practice generally is, I believe, somewhat different from other firms, that we, wherever practical, do like to make test checks of the inventory quantities in addition to the mere check of the records. . . .

We do not think that examinations we might make (in certain cases, the American Smelting and Refining Company being cited specifically) would be of sufficient value to the company to justify the expense. That is, to make an examination which would be of any value, we would have to employ a large staff of engineers and metallurgists, and even they probably would not know as much about the inventories as the company's own metallurgists know. . . .

Mr. Wellington described the audit of the inventories of Revere Cooper and Brass, Inc., as follows:

We have received certificates from officials at the several divisions of the corporation stating that the inventory quantities were determined by actual count, weight, or measurement, and that adequate provision has been made for imperfect or obsolete stocks.

The physical inventory was taken as at December 31, 1938, by employees of the company, who prepared duplicate prenumbered tickets for the various items in the inventory, retaining the duplicate and leaving the original with the item inventoried. After the inventory count was completed, we accompanied certain executives through the plants, picking up the originals of the tickets, and by various tests satisfied ourselves that the quantities as shown by the tickets were correct. We retained control of the tickets picked up and, upon accounting for all numbers and determining that the inventory had been properly taken, we traced individual items or totals to the inventory summaries prepared from the duplicate tickets. We checked the compilation of the inventory tickets and made substantial tests of the inventories at the fabricating divisions as to metal and product classifications.

In addition to establishing the correctness of the inventories as taken at the plants, we also confirmed with vendors and customers the quantities of materials belonging to the corporation at other locations or materials belonging to others in its possession. We also checked the mathematical accuracy of the calculations and summaries of the inventory sheets and satisfied ourselves that the prices used were at cost (considering the metal contents of the December 31, 1937, inventory as "cost" for 1938), which in the aggregate was below market.

**Required:**

Should the auditor accept responsibility for the valuation of inventories? Do you believe the procedure followed in the audit of the inventories of Revere Copper and Brass, Inc., to be adequate? Discuss critically.

# 8. PREPAID EXPENSES

## Derkens Manufacturing Company

During the course of your first audit of the Derkens Manufacturing Company for the year 1955, you found the end-of-the-year balance for Insurance Expense and Prepaid Insurance to be $1,800.00 and $1,560.00, respectively, made up as follows:

**INSURANCE EXPENSE**

| Date | Debit | Credit |
|---|---|---|
| 1955 | | |
| Jan. 31 | 150.00 | |
| Feb. 28 | 150.00 | |
| Mar. 31 | 150.00 | |
| Apr. 30 | 150.00 | |
| May 31 | 150.00 | |
| June 30 | 150.00 | |
| July 31 | 150.00 | |
| Aug. 31 | 150.00 | |
| Sept. 30 | 150.00 | |
| Oct. 31 | 150.00 | |
| Nov. 30 | 150.00 | |
| Dec. 31 | 150.00 | |

**PREPAID INSURANCE**

| Date | Debit | Date | Credit |
|---|---|---|---|
| 1955 | | 1955 | |
| Jan. 1 Bal. | 2,274.00 | Jan. 31 | 150.00 |
| 1 | 72.00 | Feb. 28 | 150.00 |
| 2 | 120.00 | Mar. 31 | 150.00 |
| 29 | 180.00 | Apr. 30 | 150.00 |
| 31 | 375.00 | May 31 | 150.00 |
| Mar. 5 | 192.00 | June 30 | 150.00 |
| Sept. 4 | 147.00 | July 31 | 150.00 |
| | | Aug. 31 | 150.00 |
| | | Sept. 30 | 150.00 |
| | | Oct. 31 | 150.00 |
| | | Nov. 30 | 150.00 |
| | | Dec. 31 | 150.00 |

The insurance in force on December 31, 1955, was represented by the following policies:

| *Company* | *Policy No.* | *Date of Policy* | *Term* | *Face of Policy* | *Premium* | *Coverage* |
|---|---|---|---|---|---|---|
| Aetna Fire Insurance Co. | 614079 | 1/29/55 | 1 yr. | $20,000.00 | $ 180.00 | Merchandise |
| American Surety Co. | 999070 | 1/2/55 | 1 " | Variable | 120.00 | Employees Fidelity |
| Fireman's Fund Insurance | 605118 | 7/28/54 | 3 " | $20,000.00 | 360.00 | Machinery |
| Franklin Fire Insurance Co. | 316899 | 3/5/55 | 1 " | 10,000.00 | 192.00 | Office equipment |
| General Casualty Co. | 207684 | 7/1/54 | 3 " | 10,000.00 | 300.00 | Auto liability |
| Home Fire Insurance Co. | 192031 | 1/31/55 | 1 " | 36,000.00 | 375.00 | Merchandise |
| National Fire Insurance Co. | 132407 | 9/4/55 | 1 " | 10,000.00 | 147.00 | Merchandise |
| National Fire Insurance Co. | 149816 | 1/1/54 | 3 " | 20,000.00 | 450.00 | Merchandise |
| Pacific Mutual Fire Insurance Co. | 192131 | 1/1/55 | 1 " | 5,000.00 | 72.00 | Automobiles—fire, theft |
| Phoenix Fire Insurance Co. | 171170 | 8/4/54 | 3 " | 75,000.00 | 1164.00 | Merchandise |

**Required:**

Prepare audit working papers relating to the above two accounts. Include required adjusting entries.

## Consolidated Ice Company

This is your first audit of the Consolidated Ice Company; you are examining the company's accounts for the fiscal year ending September 30, 1955. As of this date, the balance of the Insurance Expense account was $1,274.04. No Prepaid Insurance account was carried because all premium payments were immediately debited to Insurance Expense. The company's bookkeeper stated that this practice yielded a reasonably accurate figure for annual insurance expense and that more refined accounting was not "worth the time and cost involved."

The insurance carried by the company in 1955 was as follows:

| *Company* | *Policy* | *Face* | *Dated* | *Term* | *Premium* | *Coverage* |
|---|---|---|---|---|---|---|
| Allied American Mutual | F73740 | $50,000.00 | 1-14-54 | 36 mo. | $ 361.50 | Fire |
| Allied American Mutual | F73741 | 15,000.00 | 2- 1-55 | 36 " | 154.95 | Fire |
| Allied American Mutual | F73742 | 25,000.00 | 2-15-54 | 36 " | 254.94 | Fire |
| Michigan Miller's Mutual | 181040 | 5,000.00 | 10-22-53 | 36 " | 56.25 | Fire |
| Northwestern Mutual Fire | 3609960 | 5,000.00 | 10-22-53 | 36 " | 56.25 | Fire |
| Ocean Accident & Guarantee | 29444 | 1,000.00 | 2-18-54 | 36 " | 65.00 | Power plant |
| Hartford Steam Boiler | 952386 | 5,000.00 | 6-19-55 | 36 " | 253.86 | Steam boiler |
| Hartford Steam Boiler | 952837 | 25,000.00 | 5-10-54 | 36 " | 1,035.12 | Steam boiler |
| Aetna Casualty Insurance | 39MS23 | 18,000.00 | 7-14-53 | 36 " | 287.50 | Money & securities |
| Lumberman's Mutual | 884671 | Variable | 2-10-55 | 12 " | 370.54 | Automobile |
| Franklin Insurance Co. | 1064 | 75,000.00 | 3-22-53 | 36 " | 67.50 | Explosion |
| Massachusetts Bonding & Insurance Company | F52571 | 2,500.00 | 6-22-55 | 12 " | 221.99 | Employees' fidelity bonds |
| Mutual Fire Insurance Co. | 64107 | 10,000.00 | 8-24-55 | 12 " | 60.20 | Fire |
| Bell & Eaves | 33044 | Variable | 2- 8-55 | 12 " | 170.00 | Warehouse bond |
| Midwest Fire Insurance Co. | 18979 | 20,000.00 | 11- 7-54 | 12 " | 42.50 | Fire |

**Required:**

(1) Prepare audit working papers for the insurance accounts.

(2) How will the auditor use the columns headed "Face," "Prepaid Insurance," and "Insurance Expense?"

## The Delta Building

On February 18, 19—, Mr. Leonard B. Fritts purchased an office building in downtown New Orleans known as the Delta Building for a consideration of $225,000.00. A check for this amount was given to the seller.

Another check was given to the seller for $4,586.85 covering prepayment of taxes. In New Orleans there are two real estate taxes, one for the city and one for the state of Louisiana. The seller of the Delta Building had paid the city taxes for the current year but not the state taxes. It was agreed by buyer and seller that real estate taxes for the year should be divided equitably between them. The cash settlement of this apportionment was computed by attorneys as follows:

| | |
|---|---|
| Prepaid city taxes as of February 18, 19— | $5,686.85 |
| *Less* Accrued state taxes not paid as of February 18, 19— | 1,100.00 |
| Amount of check | $4,586.85 |

State taxes were 10.24 mills on an assessed valuation of $355,000.00 for the building.

None of this tax information was recorded on the books of the Delta Building on March 31, 19-- (following date of transfer of title). The Delta Building was operated as a separate business and its identity was to be kept distinct from the other interests of Mr. Fritts.

**Required:**

(1) What entry, relating to taxes, should be placed on the books of the Delta Building preparatory to the construction of a balance sheet, March 31, 19—?

# 9. FIXED ASSETS

## Sedgewick Hotel, Inc.

On December 31, 1955, the building of the Sedgewick Hotel, Inc., was carried in the ledger as follows:

HOTEL BUILDING

| | | | | | |
|---|---|---|---|---|---|
| 1938 | | | | | |
| Dec. 31 | Contract cost | 3,000,000.00 | | | |

RESERVE FOR DEPRECIATION—HOTEL BUILDING

| | | | | | |
|---|---|---|---|---|---|
| 1955 | | | 1955 | | |
| Jan. 2 | Modernization costs | 955,000.00 | Jan. 1 | Balance | 1,530,000.00 |

On December 31, 1938, the estimate of useful life for the building was $33\frac{1}{3}$ years. On January 2, 1955, after giving effect to costs of modernization, the building was estimated to have a remaining useful life of 20 years.

**Required:**

(1) How should the hotel building be valued on the balance sheet of December 31, 1955?

(2) What are the auditor's adjusting entries?

(3) What would be the essential components of your audit program for this asset?

## Winn Manufacturing Company

The Winn Manufacturing Company has a factory building that has not been used or rented over the past five years. The company possessed other more efficient facilities for manufacturing purposes.

**Required:**

What questions present themselves to the auditor in evaluating and classifying this asset for balance sheet purposes? What questions present themselves as to the amount and classification of depreciation expense on the statement of profit and loss?

## Hinton Coal Company

On December 30, 19—, the Hinton Coal Company purchased an expensive machine for the mining of bituminous coal. The invoice cost of this machine was $357,142.86, terms f.o.b. destination, and 2% cash discount if paid by January 10, 19—, and net, February 10, 19—.

**Required:**

(A). At what value should this machine appear in the balance sheet of December 31, 19— if:

(1) The invoice is discounted on December 31, 19—?
(2) The invoice is discounted on January 10, 19—?
(3) The invoice is paid net on February 10, 19—?
(4) The invoice is unpaid on December 31, 19—; and it is not known whether or not the bill will be paid within the cash discount period?

(B). Assume, alternatively, that the invoice carried no cash discount, and that it was payable as follows: $57,142.86 cash on December 30, 19—, with the balance payable in equal monthly installments of $25,000.00 (without interest) on the 10th day of each succeeding month, title to pass when the last payment has been made.

## Floyd T. Haskins

On December 31, 19—, you are making a first audit of the business of Mr. Floyd T. Haskins who started a small moving and delivery business on January 1, 19— (two years ago). His automobile account is simply:

TRUCKS

| | | | | | |
|---|---|---|---|---|---|
| (last year) | | | (this year) | | |
| Jan. 2 | Ford truck #1 (used) | 1,644.00 | Apr. 29 | Insurance collection on truck #2 | 384.00 |
| | License for truck #1 | 24.00 | Dec. 30 | Truck #1 traded in on Ford truck #4 (for an allowance of $1,050.00) | 1,644.00 |
| Feb. 10 | Repairs | 316.00 | | | |
| June 15 | Ford truck #2 (new) | 2,132.00 | | | |
| | License | 24.00 | | | |
| Sept. 30 | Repainting Ford truck #1 | 165.00 | | | |
| (this year) | | | | | |
| Mar. 17 | Ford truck #3 (new) | 2,084.00 | | | |
| Apr. 15 | Repairs on Ford truck #2, damaged in accident | 420.00 | | | |
| Dec. 30 | Ford truck #4 (new) | 2,062.00 | | | |

The commercial life of these trucks was fixed by Mr. Haskins at three years. No depreciation was ever recorded on the books although, on last year's income tax return, a deduction of $850.00 was taken.

**Required:**

(1) How should the above asset be valued on the balance sheet, December 31, 19—?

(2) What are the auditor's adjusting entries?

(3) What is the audit program for this account?

## Red & White Taxicab Co., Inc.

On December 31 of the current calendar year, the following account is found on the ledger of your client, the Red & White Taxicab Company, Inc.:

TAXICABS

| | | | | | |
|---|---|---|---|---|---|
| (last year) | | | (last year) | | |
| Jan. 1 | Chevrolet #1 | 1,782.00 | Dec. 31 | Depreciation for year | 3,389.00 |
| Apr. 1 | Hudson | 2,880.00 | (this year) | | |
| July 1 | Chevrolet #2 | 1,821.00 | Apr. 30 | Traded Hudson for allowance of | 1,800.00 |
| Oct. 1 | Packard #1 | 3,684.00 | June 15 | Sold Chevrolet #1 for cash of | 950.00 |
| (this year) | | | Dec. 31 | Depreciation for year | 6,556.00 |
| Apr. 30 | Cadillac | 4,230.00 | | | |
| June 15 | Packard #2 | 3,420.00 | | | |
| Sept. 30 | Chevrolet #3 | 1,851.00 | | | |

All automobiles were purchased with the expectation of using them for approximately three years. Depreciation expense was computed against original cost (straight-line method); residual values were disregarded.

**Required:**

You are auditing the accounts for the current year. Prepare working papers for the above account.

# C. H. Benson & Company

In the course of their examination of the accounts of C. H. Benson & Company for the year 1955, the auditing firm of Hilton & Troyer came across the following accounts in the general ledger:

TRUCKS

| | | | | | |
|---|---|---|---|---|---|
| Jan. 2, 1950 | Chevrolet #1 | 1,825.92 | Nov. 1, 1953 | Ford #1 | 400.00 |
| June 30, 1950 | Ford #1 | 2,032.00 | Aug. 1, 1954 | Chevrolet #1 | 200.00 |
| Apr. 1, 1952 | Ford #2 | 2,154.80 | | | |
| July 1, 1952 | Mack #1 | 3,484.48 | | | |
| Oct. 1, 1952 | International #1 | 3,397.00 | | | |
| Dec. 31, 1952 | White #1 | 3,209.48 | | | |
| Nov. 1, 1953 | Ford #3 | 2,169.32 | | | |
| June 30, 1954 | Ford #4 | 2,152.24 | | | |
| Aug. 1, 1954 | Studebaker #1 | 2,421.20 | | | |
| Oct. 1, 1954 | Fruehauf Trailer | 2,448.00 | | | |

RESERVE FOR DEPRECIATION—TRUCKS

| | | | | |
|---|---|---|---|---|
| Dec. 31, 1954 | Major repair on White #1 | 928.24 | Dec. 31, 1951 | 964.48 |
| | | | Dec. 31, 1952 | 964.48 |
| | | | Dec. 31, 1953 | 4,025.92 |
| | | | Dec. 31, 1954 | 4,468.25 |
| | | | Dec. 31, 1955 | 6,173.61 |

Additional information covering these accounts was:

Ford #1 was traded in on Ford #3. Chevrolet #1 was traded in on Studebaker #1. A trade-in allowance of $400.00 was received on the Ford and $200.00 on the Chevrolet.

The average life of a truck was estimated at four years. The life of the trailer, however, was estimated at six years. The company's practice was to compute its annual depreciation expense by applying the depreciation rate of 25% against the total of the debit side of the Trucks account as of January 1 of each year. Depreciation on the trailer, however, was computed at $16\frac{2}{3}$%.

The repairs on White #1 extended the life of this truck by an additional two years.

**Required:**

Prepare well-organized working papers for the above accounts which will include adjusted balances, December 31, 1955, depreciation expense for the year 1955, and adjusting entries required to bring ledger account balances up to date. In the production of these adjusted account balances, the balance of the Reserve for Depreciation account is to represent cumulative depreciation on the trucks and trailer to date—computed, however, on a monthly basis from the date on which each unit was purchased.

## Edey-Faber Company

Three years ago the Edey-Faber Company purchased, at a cost of $36,842.00, twenty Plymouth cars for the use of its salesmen. It was expected that these cars would be used four years or 100,000 miles, whichever was less. Depreciation expense was recorded in the books on a mileage basis. At the end of the three-year period the average mileage on these cars was 82,000 miles. At this date it was decided to trade ten of these cars on the purchase of ten new Plymouths invoiced at $20,108.00; the trade-in allowance received was $4,000.00. The expected service life of the new cars was fixed at 100,000 miles.

The other ten cars (of the original purchase) were retained in active service. However, each of these was immediately overhauled with the idea of procuring economical transportation from them for 100,000 miles over the next three years. For each of these overhauls, the typical cost was as follows:

| | |
|---|---|
| Repair of body, including welding in new panels and door sills, and removing dents from trunk lid and fenders | $125.00 |
| Painting—synthetic enamel, first-class job | 60.00 |
| Overhaul of entire front end; installation of king pins and bushings, knee action control arm bushings, and removal of play | 36.00 |
| Replacement of shock absorbers | 24.40 |
| Repair of master cylinder (brakes) | 8.50 |
| Replacement of universal joints, and lubrication ($1.50) | 32.50 |
| New motor, including overhaul of starter, generator, curburetor, and distributor; overhaul of transmission and clutch | 383.00 |
| New floor mat | 3.00 |
| Seat covers | 15.00 |
| Repairs to radio | 6.50 |
| | $693.90 |

In the ensuing 12 months of the calendar year under review, each of the 20 cars was operated 26,760 miles on the average.

**Required:**

(1) What entry should be made to record the purchase of the 10 new cars?

(2) What entry should be made to record the invoice for the overhaul of the 10 other cars?

(3) What is the entry for depreciation expense in the fourth year?

(4) Show how these automobiles would appear on the balance sheet, December 31 of the fourth year.

(5) What are the main steps of your audit program for the Automobile account in the third and fourth years?

## Daley Manufacturing Company

On March 1, 19—, the Daley Manufacturing Company bought land occupied by some old tenement buildings at a total purchase cost of $25,000.00 plus assumption of real estate taxes for the current calendar year. The taxes were paid on May 1, 19—, $624.00. The land, which was purchased as a site for a new factory building, was carried on the seller's books at $3,000.00 and the tenements at $7,000.00. Legal and appraisal fees, covering the search of title, preparation of contracts, property appraisal, etc., amounted to $500.00.

The tenements were razed at a cost of $3,000.00. The sale of scrap building materials yielded $425.00.

Construction of the factory building was commenced on April 1, 19— and was completed September 30, 19—. The new building was placed in use on October 1, 19—. The contract for the construction of the building called for a price of $100,000.00; and it specified payments of $10,000.00 on May 1 and monthly thereafter for four months, and $50,000.00 on October 1. The company borrowed the last $70,000.00 of these payments at 6%, and promised to repay the loan by principal payments of $5,000.00 monthly, commencing January 1 of the next calendar year. Accrued interest to date on unpaid principal was to be added to each of these disbursements. All of these payments were subsequently made on their due dates.

The architect's fee was $5,000.00.

Insurance for $25,000.00 on the construction work was taken out on May 1, 19—. This amount was amended on July 1 to $50,000.00 and to $75,000.00 on September 1. The insurance premium was 2½% of the face of the policy; and the policy itself was for a three-year period.

A portion of the land was hard-surfaced for roadway and other purposes at a cost of $2,100.00.

**Required:**

At what gross values should the land and building be carried on the balance sheet,

(a) If the company were an old company carrying on its operations in rented property up to and including September 30, 19—?

(b) If the company were organized in January of the current calendar year with its operations not commencing until October 1, 19—?

## J. B. Elwyn & Son, Inc.

Last year, after having occupied rented premises ever since the date of its organization, J. B. Elwyn & Son, Inc., purchased land and erected a new building upon it. During your audit of the following year's accounts, you examine the Land and Buildings account which has the following debits in it (and no credits), as of December 31, 19—:

Debits

| | | |
|---|---|---|
| (last year) | | |
| Mar. 2 | Purchased land and old building for | $ 100,000.00 |
| | Attorney fees and sundry costs incurred in connection with purchase | 3,000.00 |
| Aug. 17 | Cost of razing old building | 11,000.00 |
| Oct. 1 | Contract signed, for construction of new building to cost $1,000,000.00, construction to be completed on or before 1 year from today. | |
| Dec. 11 | Payment to contractor | 100,000.00 |
| 31 | Accrued taxes to date, 10/12 × $3,600.00 | 3,000.00 |
| (this year) | | |
| Feb. 1 | Payment to contractor | 100,000.00 |
| Apr. 1 | Payment to contractor | 100,000.00 |
| July 1 | Discount of 5% on 20-year, 5%, mortgage bonds of $500,000.00 par value, sold today to help finance the new building | 25,000.00 |
| | Payment to contractor | 200,000.00 |
| Sept. 30 | Accrued interest on mortgage bonds payable | 6,250.00 |
| | Accrued taxes to date, 9/12 × $3,600.00 | 2,700.00 |
| Oct. 1 | Payment to contractor | 500,000.00 |
| | | $1,150,950.00 |

No depreciation expense has yet been recorded, the company awaiting your recommendations as to a policy of depreciation.

**Required:**

(1) Prepare working papers for the land and buildings accounts. Show auditor's adjusting entries. What is a proper gross value for the building in the balance sheet, December 31, 19—?

(2) What would constitute a proper audit program for the above account?

(3) Explain how you would proceed in the formulation of a depreciation policy for recommendation to the company.

## Jay C. Bentley

Fifteen years ago a three-story business building was constructed at 272 Central Avenue. The building, constructed of brick and named the New Central Building, was primarily intended to earn revenue sufficient to pay real estate taxes and other carrying charges. Its commercial life was estimated at 20 years. Upon its completion the building represented an investment of $50,000.00, and the land $20,000.00.

Over the next fifteen years, real estate values (in the particular area in which the New Central Building was located) appreciated greatly. On November 30 of its sixteenth year, the New Central Building (and land) was sold to Jay C. Bentley. He assumed the seller's mortgage of $12,000.00 and unpaid real estate taxes for the current year, $8,000.00; and gave a check for $280,000.00 as the balance of the deal. Realtors, representing the principals, estimated that 15% of the purchase price applied to the building and 85% to the land. Mr. Bentley estimated that the remaining commercial life of the New Central Building was about five years, although its remaining physical life was estimated at ten or more years. At the end of the five-year period Mr. Bentley planned to raze the building and, in its place, erect a new and modern business structure. In line with these expectations, Mr. Bentley leased the New Central Building to the Great Atlantic Stores, Inc., for five years at an annual rental of $36,000.00 annually; and renewable for another five years at specified annual rentals depending upon whether the old or new building was occupied.

On the basis of the above estimates and lease, Mr. Bentley directed his bookkeeper to allocate 15% of the purchase price to land and 85% to the building; and to depreciate the building at the annual rate of 20%. This was done.

You are auditing the accounts of Mr. Bentley on December 31, 19—, 13 months after title to the building had passed to Mr. Bentley.

**Required:**

How would you show the above real estate on the audited balance sheet of Mr. Bentley?

## Johns-Merrill Press, Inc.

I

On January 12, 19— the Johns-Merrill Press, Inc., entered into a contract with Harold E. Frye, contractor, for the construction of a building at a price of $100,000.00, payment for the building to be made when construction was completed. Construction of the building commenced on February 15, 19—, and was completed on November 20, 19—. On October 15, 19—, the contractor found himself heavily pressed for funds. Accordingly, on October 28, he approached the Johns-Merrill Press, Inc., with an offer of a 5% discount on the contract if a cash settlement might be made within the next five days. On November 1, 19—, the Johns-Merrill Press, Inc., delivered its check for $95,000.00 to Mr. Frye and in turn received a full release from all of its obligations under the contract.

Should the building appear in the balance sheet of November 20 at $100,000.00 or $95,000.00? Why?

II

On January 1, 19— (just after the building had been finished and occupied) the Johns-Merrill Press, Inc., suddenly transferred the title of its new building (annual depreciation, 3%) to the Messina Investment Trust for a cash consideration of $140,000.00 of which $15,000 was for the land. In turn, a 25-year lease was executed under which the Johns-Merrill Press, Inc., was to act as tenant of the transferred property at a monthly rental of $1,000.00 (payable in advance) and subject to an increase of 10% every five years. The object of this arrangement was to "free capital for working capital purposes."

After operating approximately nine years under this arrangement, the Johns-Merrill Press, Inc., appraised its lease as progressively unsatisfactory and burdensome. Accordingly, the company on December 31 of the ninth year, arranged a settlement whereby the lease was canceled and the property repurchased for a total consideration of $150,000.00. Reflecting the general rise in real estate values, the fair market value of the building on this date was $110,000.00 and the land, $25,000.00. Although the seller's price on all of the realty was $150,000.00, the purchaser wished to consider $15,000.00 as the premium expense paid to obtain a cancellation of the contract of lease.

**Required:**

On January 1 of the tenth year, how should the above real estate be carried in the accounts of the Johns-Merrill Press, Inc.?

# The A. J. Milroy Corporation

On July 1, 19—, The A. J. Milroy Corporation signed a 25-year lease (without renewal clause) for some land in the industrial section of St. Louis, Missouri. The annual rental for the first 10 years was $1,500.00, and $2,000.00 thereafter, all rentals payable annually in advance. A factory building, costing $300,000.00 was erected on the site. It was occupied six months later, January 1, 19—, and it was estimated to have a serviceable life of 40 years.

Six and one-half years after the lease was signed, you are making a first audit of the company's accounts. At the end of this period, on December 31, 19—, two of the accounts in the ledger were:

**Factory Building**

| | | | |
|---|---|---|---|
| Jan. 1 | 300,000.00 | | |

**Reserve for Depreciation—Factory Building**

| | | | |
|---|---|---|---|
| | | Dec. 31 | 7,500.00 |
| | | Dec. 31 | 7,500.00 |
| | | Dec. 31 | 7,500.00 |
| | | Dec. 31 | 7,500.00 |
| | | Dec. 31 | 7,500.00 |
| | | Dec. 31 | 7,500.00 |

**Required:**

(1) Auditor's adjusting entries, if any.

(2) Would your adjusting entries have been any different if the lease had contained a clause giving the lessee the option of renewing the lease for another 15 years?

(3) On the company's federal income tax returns for the past five years, you find that the annual deduction for depreciation expense has been $10,500.00. What would you do about the discrepancy between book and tax depreciation in so far as your financial statements for the past 12 months are concerned?

## Williston & Company

During the course of their examination of the accounts of Williston & Company, one of the auditors made an inspection tour of the company's properties. He was surprised to find a new one-story building of concrete construction being used as a garage.

On inquiry the auditor found that construction of this building had been authorized by the board of directors as a research laboratory at an estimated cost of $90,000.00. Shortly before the building was completed, the Tri-Continental Chemicals Company acquired 47% of the capital stock of Williston & Company. Arrangements were then entered into whereby the research projects of both companies were to be centralized in the laboratories of the Tri-Continental Chemicals Company.

Upon consummation of this plan, the management of Williston & Company was obliged to convert its new building to some other use. For lack of other purpose, it was decided to use the new building as a garage. However, had a garage of similar proportion been planned originally, the cost of construction of a satisfactory building would not have been more than $25,000.00.

**Required:**

How should this building have been valued in the balance sheet? Should any adjusting entries be made on the audit working papers? If so, describe and defend them.

## Erie Manufacturing Company

On December 31, 19—, you find the condensed trial balance of the Erie Manufacturing Company to be as follows:

| | | |
|---|---|---|
| Cash | $117,400.00 | |
| Accounts Receivable | 149,800.00 | |
| Finished Goods | 33,000.00 | |
| Work in Process | 31,000.00 | |
| Raw Materials | 20,000.00 | |
| Delivery Equipment | 3,200.00 | |
| Factory Equipment | 60,000.00 | |
| Reserve for Depreciation—Factory Equipment | | $ 10,000.00 |
| Office Furniture and Equipment (estimated life, 12 years) | 12,000.00 | |
| Reserve for Depreciation—Office Furniture and Equipment | | 3,000.00 |
| Vouchers Payable | | 50,000.00 |
| Common Stock, $10.00 par | | 100,000.00 |
| Earned Surplus | | 250,000.00 |
| Sales | | 231,400.00 |
| Purchases | 80,000.00 | |
| Direct Labor | 42,000.00 | |
| General Factory Expense | 12,000.00 | |
| Indirect Labor | 17,000.00 | |
| Selling Expense | 43,000.00 | |
| General Administrative Expense | 24,000.00 | |
| | $644,400.00 | $644,400.00 |

No depreciation expense for the current year has been recorded. With reference to depreciation you find that the delivery equipment was purchased new on June 30 of the current audit year (estimated life, four years). On the date of the above trial balance the remaining life of the office equipment was estimated at eight years; this was after four years of use. In past years factory equipment was depreciated at the annual rate of 5% but it is now found that the rate should have been 10%. (Use straight-line depreciation. Disregard scrap values.)

New inventories on December 31, 19—, are: finished goods, $45,000.00, work in process, $25,000.00, raw materials, $30,000.00.

**Required:**

(1) Profit and loss statement (in detail) for the year. Use the "all-inclusive" style of income statement.

(2) Balance sheet, December 31, 19—.

(3) How would you satisfy yourself as to the adequacy of the company's rates of depreciation?

## Nash-Hayes Company

On December 31, 19—, the condensed trial balance of the Nash-Hayes Company was:

| | | |
|---|---|---|
| Sundry Assets (net) | $1,107,300.00 | |
| Land | 20,000.00 | |
| Building, cost (annual depreciation rate, $3\frac{1}{3}\%$) | 189,000.00 | |
| Building, appraisal increase | 374,000.00 | |
| Reserve for Depreciation | | $ 63,000.00 |
| Prepaid Fire Insurance (as of Jan. 1, current year) | 6,000.00 | |
| Common Stock, $100.00 par | | 1,000,000.00 |
| Earned Surplus | | 200,000.00 |
| Appraisal Surplus | | 374,000.00 |
| Sales | | 2,045,000.00 |
| Cost of Sales | 1,281,000.00 | |
| Operating Expenses (excluding depreciation and insurance expense) | 704,700.00 | |
| | $3,682,000.00 | $3,682,000.00 |

The appraisal was recorded on January 1 of the current year so that the ledger would reflect the current market value of the building, $500,000.00. The prepaid insurance premiums expire December 31 (next year); the policies were of $325,000.00 face value and carried coinsurance clauses of 80%.

On December 30 of the current year, about $\frac{1}{5}$ of the building was destroyed by fire, the loss being estimated at $100,000.00.

**Required:**

(1) Profit and loss statement for the year.

(2) Balance sheet, December 31, 19—.

(3) What are the major components of your audit program for the verification of the value of the building in the balance sheet of December 31, 19—?

## Black Diamond Coal Company

On January 1, 1952, the John J. Heckert Coal Company purchased a coal property for a cash consideration of $1,500,000.00. The property was estimated to contain 14,000,000 tons of coal and to have a residual value of $70,000.00 after the abandonment of mining operations. In addition to its initial investment, the company disbursed $110,000.00 in developmental costs. In the first year of operations, 420,000 tons of coal were mined, 378,000 tons were sold for $490,000.00, and cash mining expenses were $350,000.00. Selling and general administrative expenses amounted to $50,000.00.

On January 1, 1953, the Black Diamond Coal Company purchased the business of the John J. Heckert Coal Company. The inventory of coal above ground was purchased at book value, and the underground coal reserves were purchased for a cash consideration of $1,500,000.00. The Black Diamond Coal Company estimated the remaining recoverable commercial tonnage of the mine at 10,000,000 tons. The Black Diamond Coal Company erected mine buildings costing a total of $75,000.00 (estimated life 15 years). No residual value was attached to either the land or the buildings.

In its first year of operations the Black Diamond Coal Company mined 1,100,000 tons of coal and, at the end of the year, had 100,000 tons of coal still on hand unsold. Sales for the year 1953 were made at an average price of $3.00 per ton. Cash mining costs were $2,015,750.00, and cash selling and general administrative expenses amounted to $746,380.00.

**Required:**

(1) Prepare the profit and loss statement of the Black Diamond Coal Company for the year 1953.

(2) How would the declaration of a cash dividend of $300,000.00 be reflected on the company's balance sheet? A cash dividend of $400,000.00?

(3) What are some of the distinctive requisites of an audit program for the Black Diamond Coal Company?

## Chuce Mining Company

In your first audit of this company, you find the following balances on the books, as of December 31, 19—:

| | |
|---|---|
| Chuce Mine, at cost | $ 408,314.00 |
| Chuce Mine, appraisal increase | 3,591,686.00 |
| Reserve for Depletion (cost) | 41,371.00 |
| Reserve for Depletion (appraisal increase) | 384,179.00 |
| Revaluation Surplus | 3,574,450.00 |

**Required:**

Prepare an audit program for the examination of this asset.

## Clayborne Brick Company

John H. Clayborne was a brick manufacturer doing business as the Clayborne Brick Company. For the year 19— the condensed statement of income for the business was as follows:

| | | |
|---|---|---|
| Sales, 50,000 M | | $2,000,000.00 |
| Costs: | | |
| Production Costs | $1,925,000.00 | |
| Distribution and Administrative Costs | 275,000.00 | 2,200,000.00 |
| Net Loss | | $ 200,000.00 |

During the course of your audit, the following information was discovered:

(1) The inventory of finished bricks on January 1, 19—, was 6,000 M correctly costed at $153,000.00; and on December 31, 19—, 5,000 M tentatively costed at $150,000.00. However, in setting up the above income statement, inventories were disregarded because "of their nominal difference." Neither of these inventories was recorded on the books. There were no other inventories.

(2) Of the bricks produced during the year, 1,180 M were spoiled and of no value.

(3) The company constructed a new building-and-warehouse during the year. All expenditures relating to this construction were charged against profit and loss for the year. In the construction of the building-and-warehouse 10,000 M bricks were used.

(4) The wage cost of producing bricks, including spoiled bricks, was $15.00 per M.

(5) Of the production costs of $1,925,000.00, $500,000.00 represented the cost of labor used in construction ot the new building-and-warehouse as well as the cost and installation of special equipment integral with the building.

(6) Mr. Clayborne's annual salary of $50,000.00 was debited to Distribution and Administrative Costs, as in preceding years. In contrast to preceding years, when all of his time was spent as general manager of production and distribution, the time of Mr. Clayborne in the current year was expended approximately as follows:

40% to general supervision, about evenly divided between brick production and distribution;

25% to general supervision over the construction of the new building-and-warehouse;

25% to supervision of experimental research in the matter of using sugar as a fluxing agent in the processing of brick;

10% to negotiations for the purchase of the business of the Luster-On Ceramics Company. These negotiations were successfully concluded by a contract for purchase signed December 19, 19—, title and consideration to pass as of January 10 of the following calendar year.

In the preceding year the business had sold 51,112 M bricks but had not engaged in the construction of any fixed assets.

**Required:**

(1) Corrected statement of income, showing details as much as possible.

(2) Gross cost of the new building-and-warehouse as it would appear in the balance sheet. (Note.—In the financial statements, show whole dollars only.)

(3) In so far as production costs, the cost of inventory, and the cost of the building, are concerned, what are the main points to be covered in your audit program for these costs?

## Clinton, Reed, & Smith

As of June 30, 19—, L. E. Clinton, T. H. Reed, and G. F. Smith organized a contracting business with initial cash capitals of $50,000.00, $25,000.00, and $25,000.00, respectively. They were to share profits in the ratios of 60-20-20, respectively, after interest on beginning capital balances at the annual rate of 8%.

On July 1, 19—, the partners obtained a contract from Vendome Associates, Inc., for the construction of a building at a contract price of $500,000.00, payable in two installments, the first installment to be for $250,000.00, less 10% held back until completion of the contract. The first installment was payable when the job was 60% finished. The second installment of $275,000.00 was payable when the building was completed and accepted.

As soon as the contract for the building had been signed, the partners borrowed $25,000.00 cash from the First National Bank on a 6-months' note (due January 1, 19—), and carrying interest at 6% annually.

The estimated cost of the building was $400,000.00. By December 31, 19—, the costs on the contract were as follows: labor, $60,000.00, and accounts payable for materials and supplies, $180,000.00. With the contract 60% completed, the first installment was collected, and, of the cash on hand, $125,000.00 was used to pay accounts payable. Remaining costs to complete the contract were estimated at $160,000.00 of which $100,000.00 was labor.

**Required:**

(1) Balance sheet of the partnership, December 31, 19—, profits to date not taken up.

(2) Balance sheet of the partnership, December 31, 19—, profits taken up on basis of percentage of job completion to date.

(3) On December 31, 19—, how should this contract be reflected in the balance sheet of Vendome Associates, Inc.?

## Iberia Sulphur Company

Five years ago the Iberia Sulphur Company acquired a 15-year lease covering certain mineral properties estimated then to contain 5,000,000 tons of sulphur. At the end of the fifth year, the company's condensed trial balance was substantially as follows:

| | | |
|---|---|---|
| Cash | $ 8,070,000.00 | |
| Inventory, 100,000 tons | 1,500,000.00 | |
| Leasehold (original cost) | 630,000.00 | |
| Development Costs | 560,000.00 | |
| Plant and Equipment (commercial life estimated to be not in excess of 20 years; no scrap value) | 1,540,000.00 | |
| Accounts Payable | | $ 100,000.00 |
| Common Stock, $10.00 Par | | 1,000,000.00 |
| Surplus | | 1,200,000.00 |
| Sales | | 32,000,000.00 |
| Cost of Sales | 14,250,000.00 | |
| Selling and General Expenses (cash) | 7,750,000.00 | |
| | $34,300,000.00 | $34,300,000.00 |

In the course of the first audit of the company's accounts—for the fifth year—you find that no depreciation, depletion, or amortization has ever been taken. Production statistics (in tons) are:

| | | | | | |
|---|---|---|---|---|---|
| 1st year | 300,000 | 3rd year | 380,000 | 5th year | 550,000 |
| 2nd year | 350,000 | 4th year | 420,000 | | |

At the end of the fifth year, production engineers of the company estimated that there were still some 5,000,000 tons of recoverable sulphur worth about $2.00 a ton if sold as a mining property.

**Required:**

(1) Prepare the condensed audited financial statements of this company for the fifth year.

(2) Discuss some of the important components of the audit program for this company.

## The Maritime Building, Inc.

The Maritime Building was purchased by The Maritime Building, Inc., on September 1, 19—, for a total price of $600,000.00. The Maritime Building, Inc., was a new corporation organized to own and operate the Maritime Building. The principal stockholder of the new corporation was Mr. Leon J. Moley.

At Mr. Moley's request, an appraisal of the property was made by the appraisal firm of Reed & Taylor. They reported as follows:

Dear Mr. Moley:

Our estimate of the present replacement cost of the Maritime Building is $1,576,680.67, made up as follows:

| | |
|---|---|
| Brickwork | $ 72,573.12 |
| Waterproofing | 5,205.04 |
| Excavation and shoring | 46,101.77 |
| Piling (round and sheet) | 49,076.08 |
| Reinforced concrete | 41,342.88 |
| Cement work and paving | 1,635.87 |
| Fireproofing | 123,731.21 |
| Plaster and lath | 73,614.12 |
| Terra cotta | 5,502.47 |
| Cut stone and granite | 56,065.71 |
| Millwork | 65,434.78 |
| Carpenter work | 45,804.34 |
| Roofing | 1,338.44 |
| Metal doors and windows | 21,415.02 |
| Glass and glazing | 16,209.98 |
| Painting and decorating | 33,758.40 |
| Ornamental iron | 71,532.11 |
| Structural steel | 147,971.82 |
| Hardware | 22,158.59 |
| Plumbing | 98,300.88 |
| Heating and ventilating | 41,640.31 |
| Electric wiring | 70,491.10 |
| Elevators | 88,039.52 |
| Marble and tile work | 67,516.79 |
| Mail chute | 1,635.87 |
| General conditions (permit, bond, insurance, etc.) | 103,952.06 |
| Contractor's profit | 115,403.15 |
| Architect | 89,229.24 |
| | $1,576,680.67 |

On December 31 of the year of purchase, the ledger of The Maritime Building, Inc., showed the following balances:

| | | |
|---|---|---|
| Land | 54,964.03 | |
| Building | 545,035.97 | |
| Reserve for Depreciation | | 8,443.75 |

During your audit of The Maritime Building, Inc., for the four months ending December 31, 19—, you found the following entry in the cash payments book:

| | | | |
|---|---|---|---|
| Sept. 1 | Land | 54,964.03 | |
| | Building | 545,035.97 | |
| | Cash | | 600,000.00 |
| | To record purchase of the Maritime Building. Above asset values recorded as per direction of Tanney & Dale, certified public accountants. | | |

In support of this entry there was appended the report of the accountants, as follows:

### Report

The Maritime Building was purchased on September 1, 19—, at a total cost as a unit of $600,000.00. An appraisal was made by Reed & Taylor, the replacement cost being summarized as follows:

| | | | |
|---|---|---|---|
| Plumbing | | $ 98,300.88 | 7.75% |
| Heating and ventilating | | 41,640.31 | 3.29 |
| Electrical wiring | | 70,491.10 | 5.56 |
| Elevators | | 88,039.52 | 6.94 |
| Building | | 969,624.41 | 76.46 |
| | | $1,268,096.22 | 100.00% |
| General conditions | $103,952.06 | | |
| Contractor's profit | 115,403.15 | | |
| Architect's fee | 89,229.24 | 308,584.45 | |
| | | $1,576,680.67 | |

General Conditions, Profits, and Fees, are distributed as follows in accordance with the above percentages:

| | *Cost* | *General Conditions, Profits, and Fees* | *Total* |
|---|---|---|---|
| Plumbing | $ 98,300.88 | $ 23,915.29 | 122,216.17 |
| Heating and ventilating | 41,640.31 | 10,152.43 | 51,792.74 |
| Electrical wiring | 70,491.10 | 17,157.30 | 87,648.40 |
| Elevators | 88,039.52 | 21,415.76 | 109,455.28 |
| Building | 969,624.41 | 235,943.67 | 1,205,568.08 |
| | $1,268,096.22 | $308,584.45 | $1,576,680.67 |

The value of the land was fixed at $159,000.00 by Keagan & Hale, realtors, by comparison of current sales of land in the same general vicinity. Therefore, the total replacement cost is:

| | |
|---|---|
| As above | $1,576,680.67 |
| Land | 159,000.00 |
| | $1,735,680.67 |

Cost of $600,000.00 ÷ $1,735,680.67 = 34.5686% or the relative amount of replacement value.

After applying this percentage to replacement values as determined, the purchase price of $600,000.00 is distributed as follows:

| | | | | | |
|---|---|---|---|---|---|
| Land: | 34.5686% | × | $ 159,000.00 | = | $ 54,964.03 |
| Building: | " | × | 1,205,568.08 | = | 416,747.65 |
| Plumbing: | " | × | 122,216.17 | = | 42,248.38 |
| Heating and ventilating: | " | × | 51,792.74 | = | 17,904.01 |
| Electrical wiring: | " | × | 87,648.40 | = | 30,298.80 |
| Elevators: | " | × | 109,455.28 | = | 37,837.13 |
| | | | $1,735,680.67 | | $600,000.00 |

The purchase price should therefore be recorded on the books as follows:

| | | |
|---|---|---|
| Land | 54,964.03 | |
| Building | 545,035.97 | |
| Cash | | 600,000.00 |

The balance of $8,443.75 in the Reserve for Depreciation account on December 31, 19—, was explained by the following analysis of depreciation expense for the period, September 1–December 31, 19—:

| | | | | | |
|---|---|---|---|---|---|
| Building: | 3% | × | $416,747.65 | = | $12,502.43 |
| Plumbing: | 10% | × | 42,248.38 | = | 4,224.84 |
| Heating and ventilating: | 10% | × | 17,904.01 | = | 1,790.40 |
| Electrical wiring: | 10% | × | 30,298.80 | = | 3,029.88 |
| Elevators: | 10% | × | 37,837.13 | = | 3,783.71 |
| | | | | | $25,331.26 |
| | | | | | ÷ 3 |
| | | | | | $ 8,443.75 |

**Required:**

As an expert auditor, examine the valuations which appear on the books of The Maritime Building, Inc., as described above. If you do not agree with them, indicate why and give the entries necessary to adjust the accounts according to your views—to be described in your own working papers.

## Charlton Ice Company

Following are some of the invoices covering expenditures of the Charlton Ice Company for the calendar year 19—. Examine these invoices and state whether these invoices should be debited to asset or expense accounts.

| | | | |
|---|---|---|---|
| Feb. 28 | Prager, Incorporated: | | |
| | Make 3 agitators as per drawing and instructions, materials, $60.00; labor, $225.00; tax, $1.80 | | $ 286.80 |
| Mar. 13 | Webb Engineering and Supply Company: | | |
| | 14 3 FJ—61 large plates | $ 33.11 | |
| | 14 4 FJ —61 small plates | 33.11 | |
| | 12 3R-25731 discharge valve ring plates | 40.26 | |
| | 12 2R-25731 discharge valve ring plates | 25.77 | |
| | 72 2R-20579 discharge valve springs | 19.80 | |
| | 7 50 FJ—258 suction valves | 162.90 | |
| | | $314.95 | |
| | 3% tax | 9.45 | 324.40 |
| 22 | New Orleans Armature Works: | | |
| | Furnish new coils and rewind stator for Ideal 150 HP 120 RPM 2200 volt, 3 phase motor | | 1,064.92 |
| 28 | New Orleans Armature Works: | | |
| | Repair windings and bearings, clean, assemble and test pump motor, 75 HP General Electric motor | | 87.50 |
| Apr. 9 | New Orleans Armature Works: | | |
| | Furnish new coils and rewind stator for Ideal 150 HP 120 RPM 2200 volt, 3 phase motor | | 1,064.92 |
| 10 | W. G. Murtes & Company: | | |
| | Painting building | | 577.20 |
| May 3 | New Orleans Armature Works: | | |
| | Furnish new coils and rewind stator for Ideal 140 HP 120 RPM 2200 volt, 3 phase motor | | 1,064.92 |
| 14 | New Orleans Armature Works: | | |
| | Rewind stator, install new bearings, assemble and test, labor partly on overtime. | | |
| | 60 HP 900-3-60-2200 General Electric motor | | 375.00 |
| 17 | Accardo Sales Company: | | |
| | 7 2-100 Industrial fixtures and installation | $316.26 | |
| | 1 3-40 Industrial fixture | 36.87 | |
| | Moved and reinstalled 1-3-40 fixture | 5.00 | |
| | 2 new outlets | 14.00 | |
| | | $372.13 | |
| | 3% sales tax | 10.59 | 382.72 |
| 17 | Guaranty Plumbing Company: | | |
| | Installed 15 gal. hot water heater and connected fixtures on white and colored side to same with hot water; also installed new 2″ galv. gas main. Labor, materials, and heater | | 376.00 |
| 31 | W. G. Murtes & Company: | | |
| | Labor for painting building | | 1,136.70 |

| | | | | |
|---|---|---|---|---|
| June | 10 | Electrical Supply Company: | | |
| | | 1,000 feet 500.000 CM cable | $471.20 | |
| | | 2 30″ reel 214074 | 14.00 | |
| | | Tax | 14.56 | 499.76 |
| July | 17 | Groesbeck-Clotworth Company: | | |
| | | Cleaning corrugated iron roof, tightening up all loose corrugated iron sheets, then coating the entire roof area with Flintkote Fibrated Emulsion, as per contract | | 392.00 |
| | 23 | Old Dutch Paint Shop: | | |
| | | For painting building | | 1,743.00 |
| | 31 | Hillett & Son: | | |
| | | For remodeling office. Labor, materials, social security, and insurance | | 447.14 |
| Aug. | 3 | Mundet Cork Company: | | |
| | | 102 feet 2½ Spec. Th. Brine Pipe Covering | $357.00 | |
| | | 102 feet 3 " " " " " | 402.90 | |
| | | 1 1½ spec. th. brine scd. angle valves | 5.40 | |
| | | 3 1½ spec. th. brine scd. ells | 12.00 | |
| | | 1 1 " " " " " | 3.10 | |
| | | 1 1 " " " " angle valves | 4.00 | |
| | | 48 feet 1½ spec. th. brine pipe covering | 139.20 | |
| | | 9 feet 1 " " " " " | 23.40 | |
| | | | $947.00 | |
| | | Less 56½% | 535.05 | |
| | | | $411.95 | |
| | | 4 gallons waterproof cement | 9.60 | 421.55 |
| Sept. | 4 | Old Dutch Paint Shop: | | |
| | | For painting two elevator shafts in cold storage building | | 240.00 |
| | 4 | Old Dutch Paint Shop: | | |
| | | Labor and material for painting elevator shaft and vestibule on first and second floors and also steel and iron works in back of metal building in ice plant. Labor, $126.00; materials, $53.00; other, $47.43 | | 226.43 |
| | 10 | American Elevator & Electric Company, Inc.: | | |
| | | Install oil electric elevator | | 54.73 |
| | | American Elevator & Electric Company, Inc.: | | |
| | | Furnish labor and material to run feeders to #1 and #2 elevators. | | |
| | | Labor | $147.47 | |
| | | Material | 92.12 | |
| | | Profit, 10% | 9.21 | |
| | | Sales tax | 2.76 | 251.56 |
| Nov. | 6 | Lewis Sheppard Products, Inc.: | | |
| | | 4 type QM 36″ × 60″ Std. Floormaster Trucks, capacity, 2,000,000#. Rack design #3, 25″ above deck. Equipped with semisteel wheels | | 170.80 |
| | 13 | Harris & Nunn: | | |
| | | Make up 150 return bends for "A" tank | | 525.00 |
| | 22 | Jorday Brothers: | | |
| | | Work completed in private offices #1 and #2, and lavatory, and materials delivered for main office area | | 264.00 |

| | | | |
|---|---|---|---|
| Nov. 30 | Groesbeck-Clotworth Company: | | |
| | Waterproofing parapet walls up the four gables of the cold storage building | | 110.00 |
| Dec. 8 | ILG Electric Ventilating Company: | | |
| | 1 BC 30 Blower 102, MB49302, discharge & drive: 5F, approx. speed 1140, 220 volts, AC current, 60 cycle, 3 phase, serial #180087 | | 120.75 |
| 11 | Standard Supply & Hardware Company: | | |
| | 11 lgths. 12″ std. bl. wrought steel pipe, 236.34 c. ft. | $522.90 | |
| | 3 12″ std. blk. C.I. flange end 90° ells F & D | 87.79 | |
| | 6 12″ × 19″ std. blk. C.I. companion flanges F & D | 32.86 | |
| | 72 7/8″ × 3½″ machine bolts w/H.P. Hex. Nuts | 7.80 | |
| | 12 Std. Tenax Gaskets | 4.20 | |
| | 3 12″ threads | 8.25 | |
| | 1 12″ thread (your pipe) | 2.75 | |
| | | $666.55 | |
| | City and state sales taxes | 20.00 | 686.55 |
| 12 | Standard Supply & Hardware Company: | | |
| | 3 8 C.I. Flanged ells F & D | $ 38.52 | |
| | 4 lgths. 8″ std. blk. pipe P.E. 80′3″ | 101.45 | |
| | 1 8″ std. blk. pipe coupling | 3.17 | |
| | 6 8″ × 3½″ std. C.I. flanges F & D | 16.32 | |
| | 13 8″ threads (your pipe) | 22.75 | |
| | 1 12″ thread | 2.75 | |
| | 6 8″ screw up | 4.80 | |
| | 48 ¾″ × 3¼″ blk. machine bolts w/C.P. hex. nuts | 3.64 | |
| | 2 pc. 6 std. blk. pipe 2″ T.O.E. 110.16 c. ft. | 2.57 | |
| | 2 6″ cuts on above | 1.00 | |
| | 2 6″ threads on above | 2.00 | |
| | | $198.97 | |
| | City and state sales taxes | 5.97 | 204.94 |

# 10. INTANGIBLE ASSETS

## Royal Spring Tonic Company

The Royal Spring Tonic Company was a manufacturer and distributor of a line of patent medicines, chief of which was its "Royal Spring Tonic." The company's president and chief stockholder was Mr. Charles F. Metzger. The company had been in business for about 12 years and its accounts, as of December 31 (last year), were being audited for the first time. The Formula account had a balance on this date of $100,000.00, having been created by the following entry 11 years ago:

| | | |
|---|---|---|
| Formula | 100,000.00 | |
| Common Stock | | 100,000.00 |
| To record issuance of 1,000 shares of capital stock ($100.00 par) to Charles F. Metzger in payment of formula for Royal Spring Tonic. | | |

**Required:**

(1) How would you classify and value this asset in your audited balance sheet?

(2) What amortization policy, if any, should be applied against this asset?

(3) How would you verify this asset?

(4) How would your audit statements and report be affected if you were unable to verify satisfactorily the value of $100,000.00?

## Warren T. Jarvis Coin Vending Machines, Inc.

At the close of the past calendar year, the balance of the Patents account of the Warrent T. Jarvis Coin Vending Machines, Inc., was $255,000.00. This balance was made up as follows:

| | |
|---|---|
| December 31, 19— (previous year), Balance | $125,000.00 |
| Expenses of research department. No new patentable or profitable products were developed during the year but some promising possibilities were discovered as a result of the work performed | 75,000.00 |
| Patents purchased and actively used in the manufacturing operations of the Company | 25,000.00 |
| Salary, director of research | 10,000.00 |
| Patents purchased but not used in the manufacturing operations of the company. These patents were purchased to prevent a certain competitor from obtaining them and, possibly, affecting the company's present products adversely | 20,000.00 |
| | $255,000.00 |

**Required:**

At what gross value should the patents be carried in the balance sheet of December 31, 19— (current audit year)? How should these values be audited? What questions are raised when the net book values of the patents are to be determined?

## Camplin & Company

In 19—, Camplin & Company leased some land for 21 years at an annual rental of $9,000.00 without privilege of renewal. In addition to these annual payments, a bonus of $21,000.00 was paid to the lessor on the date of the signing of the lease.

As soon as it came imto possession of the land, the company proceeded to erect a building on the leased land; construction was completed in 12 months; occupancy of the building commenced January 1 of the second year of the lease. The building, which cost $255,000.00, was estimated to have a life of 25 years.

At the end of ten years, the above lease was canceled and a new one executed for the next 20 years; the annual rental was increased to $11,000.00. On December 31, 19— (the eleventh year), the condensed trial balance of the company was:

| | | |
|---|---|---|
| Building | $ 255,000.00 | |
| Reserve for Depreciation—Building | | $ 114,750.00 |
| Prepaid Bonus | 21,000.00 | |
| Sundry Assets (net) | 1,627,750.00 | |
| Capital Stock, $100.00 par | | 1,000,000.00 |
| Surplus | | 600,000.00 |
| Sales | | 3,000,000.00 |
| Cost of Sales | 2,000,000.00 | |
| Sundry Operating Expenses, paid in cash | 800,000.00 | |
| Rent Expense | 11,000.00 | |
| | $4,714,750.00 | $4,714,750.00 |

**Required:**

Condensed profit and loss statement for the eleventh year.

## E. I. Du Pont De Nemours & Company
## Remington Rand Inc. Sears, Roebuck & Co.
## McCall Corporation

The following items have appeared on recent balance sheets of the companies named:

| | |
|---|---|
| *E. I. Du Pont de Nemours & Company:* | |
| Goodwill, Patents, Trade-marks, etc. | $40,616,554.00 |
| *Remington Rand Inc.:* | |
| Goodwill, Patents, etc. | 1.00 |
| *Sears, Roebuck and Co.:* | |
| Goodwill | 1.00 |
| *McCall Corporation:* | |
| Intangible Assets (less reserve $441,860.00) | 8,365,931.00 |

In support of this latter item, the McCall Corporation stated that it represented:

| | |
|---|---|
| Par value of (old) capital stock of McCall Corporation, issued in 1913 for stock The McCall Company (dissolved October 31, 1936), in excess of net tangible assets of latter company at acquisition | $6,508,403.00 |
| Market value of stock of McCall Corporation, issued in 1929 for stock of The New Publishing Company (dissolved December 29, 1936) which owned *Redbook* and *Blue Book*, in excess of net tangible assets of latter company at acquisition | 2,283,627.00 |
| Sundry models, trade-marks, etc., acquired in 1917 and 1932 at cost | 15,761.00 |
| | $8,807,791.00 |
| *Less* Reserve for reduction of goodwill | 441,860.00 |
| | $8,365,931.00 |

It was further stated:

The above reserve for reduction of goodwill represents transfers from reserves set up in connection with the retirement of the preferred stock which was previously outstanding. These reserves were created by charges to earned surplus at various dates from 1913 to 1927.

The company has not made any provision for amortizing its intangible assets by charges against income because, in the opinion of the company, there is no evidence that the term of existence of such intangibles has become limited.

**Required:**

How should the above values be verified? Do you approve them? Why? Should any of these values be amortized by debits against periodic income?

## Baxter Manufacturing Company

The Baxter Manufacturing Company occupied a manufacturing plant near the center of the west coast city of Brookland. With growth and shifts in the trading and residential areas of the city, the locale of the company's manufacturing facilities became progressively undesirable. Finally a new location near the waterfront of Brookland was secured where all modes of transportation were readily accessible. A new factory building, incorporating the latest improvements, was erected on the new site.

With the occupancy of the new plant, the old manufacturing facilities became idle property. After two years of idleness, the properties were finally leased to the Sundure Paint Company for five years at an annual rental of \$50,000.00, with an option to purchase the properties for \$1,000,000.00. Should the option to purchase be exercised, it was agreed that 40% of each annual rental might be used as partial payment of the purchase price. Should the option not be exercised, the annual payments of \$50,000.00 were to be regarded simply as rent.

On the date the properties were occupied by the Sundure Paint Company, the book value of the properties on the books of the lessor were as follows: land, \$75,000.00; building, \$800,000.00; reserve for depreciation, \$320,000.00 (annual rate, 5%). The costs of all subsequent improvements to the property, it was mutually agreed, were to be borne by the lessee. The improvements were to become the property of the Baxter Manufacturing Company if the purchase option had not been exercised by the end of the five-year lease period. During the second year of its lease, the Sundure Paint Company made permanent improvements whose aggregate cost was \$250,000.00. These improvements added to the usefulness of the properties in question although they did not increase the estimate of over-all useful life which, from the beginning of its occupancy of the properties, the Sundure Paint Company placed at 25 years.

**Required:**

At the end of the third year, with the purchase option still unexercised, you are preparing financial statements for the Baxter Manufacturing Company. The following questions are raised:

(1) Should depreciation expense on the old building be recorded? If so, how should it be classified?

(2) How should the annual collections of \$50,000.00 be reflected in the financial statements?

(3) How should the old land and building appear in the statements of the Baxter Manufacturing Company?

(4) Alternatively, how should the transactions relating to these properties be shown on the financial statements of the Sundure Paint Company at the end of the third year of occupancy?

(5) If the purchase option is allowed to expire, what entries should be placed on the books of the Baxter Manufacturing Company?

## Haines & Coverly, Inc.

In your audit of the accounts of Haines & Coverly, Inc., for the year ending December 31, 19—, you find the Deferred Charges account with a balance of $11,960.00, comprised of the detail shown below. All charges occurred during the current year of audit.

| Debits | |
|---|---|
| Organization expenses | $ 2,720.00 |
| Sandblasting of exterior stone front oı building (the cost of which is being amortized over the lease period of 10 years) | 3,000.00 |
| Cost of rearranging construction and layout of cashier's cage (no amortization policy to date) | 1,130.00 |
| Inventory adjustments: | 4,810.00 |
| Throughout the year, the company followed a regular program for interim examinations of various sections of its inventory. Differences between book value and actual physical inventory were debited or credited to the Deferred Charges account. | |
| Transportation charges prepaid on merchandise shipped on consignment, none of which has been sold by consignee | 300.00 |
| | $11,960.00 |

Total assets of the company approximated $200,000.00.

**Required:**

(1) How should these charges be classified and valued in your audited financial statements?

(2) How should these charges be verified?

## Virginia Temple Company, Inc.

The Virginia Temple Company, Inc., was organized on January 1, 19—, ten years ago. Its manufacturing and sales activities, however, did not commence until the following January 1. At the end of the 10-year period, December 31, 19—, the Deferred Charges account of the company contained the following items:

| | | |
|---|---|---|
| Organization expenses (including losses of the second year, \$20,061.90, and the third year, \$5,107.69) | | \$ 36,014.72 |
| *Current year:* | | |
| April 1 | Bankers' fee for underwriting the sale of \$1,000,000.00 par value $5\frac{1}{2}\%$ preferred stock | 15,000.00 |
| June 30 | Cost of rearranging internal layout of manufacturing facilities | 21,722.81 |
| Oct.-Dec. | Cost of advertising campaign incurred in launching company's new product, Virginia Temple Shampoos | 300,000.00 |
| | Sales of this product in Oct.-Dec. were \$250,000.00<br>Sales for the next 12 months were budgeted at \$5,000,000.00. | |
| Dec. 31 | Expenses incurred in negotiations looking to the purchase of the Listeen Dentifrice Company. (NOTE.—As of the date of your audit, negotiations were still in process.) | 4,129.87 |
| | Balance | \$376,867.40 |

**Required:**

How should these accounting values be verified and handled in the preparation of the profit and loss statement and balance sheet? What are the principles involved?

# 11. CURRENT LIABILITIES

## The Tucker Corporation

In your examination of The Tucker Corporation for the calendar year of 19—, you find that the company places all liabilities scheduled for near-term payment in the voucher register. On December 31, 19—, the balance of the Vouchers Payable account was made up as follows:

| | |
|---|---|
| Merchandise purchases, of which 20% are overdue for payment......... | $ 48,000.00 |
| Sundry supplies and expenses........................................ | 7,000.00 |
| December payroll.................................................... | 60,000.00 |
| Dividends payable................................................... | 100,000.00 |
| Federal and state income taxes...................................... | 212,000.00 |
| One-year note payable favor of the First National Bank, due next February 1 | 100,000.00 |
| December sales taxes................................................ | 4,100.00 |
| Social security taxes............................................... | 12,000.00 |
| Withholding income taxes payable.................................... | 40,000.00 |
| Balance............................................................. | $583,100.00 |

**Required:**

(1) How should these items be shown on the balance sheet?

(2) What should be the audit program for the verification of notes payable?

(3) How would you verify the other liabilities?

## J. G. Rollins Corporation

During your audit of the J. G. Rollins Corporation for the past calendar year, you notice an entry in the voucher register of the following January; this is an invoice of the Allentown-Lincoln Company covering one Lincoln automobile, $3,126.88.

This car was purchased by the corporation for the special use of the president of the company, Mr. J. G. Rollins. It was sky-blue in color and was equipped with radio, telephone, white side-wall tires, and certain other accessories. The car was shipped from the factory in Detroit on December 23, f.o.b. destination, sight-draft bill of lading attached. It arrived in Allentown, December 29. It was ready for delivery on December 30 and Mr. Rollins was so notified at 4:30 P.M. of that day. However, delivery was actually made on January 2.

**Required:**

(1) On December 31, 19—, is this transaction a liability of the J. G. Rollins Corporation or of the dealer, or does no liability exist with respect to either of these parties?

(2) Assume that Mr. Rollins had accepted delivery on the afternoon of December 31, 19—, and had made a down payment of $1,000.00, the balance to be paid in monthly installments of $100.00, title to pass with the payment of the last installment. How should the transaction be reflected in the balance sheet of December 31, 19—?

(3) What is the importance of f.o.b. terms in deciding whether or not a liability exists as of December 31? If the car had arrived in Allentown on January 2, whose car is it if freight terms are f.o.b. destination? F.o.b. shipping point?

(4) Why is it important to examine carefully in-transit items as of the end of a fiscal period? And the voucher register for the opening days of the new fiscal period?

## J. Edwin Hart Company

You are examining the accounts of the J. Edwin Hart Company for the past calendar year. In the accounts payable ledger is the following account of a trade creditor:

### EVANS, FENWITZ & COMPANY

| | | | | | | |
|---|---|---|---|---|---|---|
| Oct. | 22 | ..................... | P | | 1,231.10 | 1,231.10 |
| | 23 | ..................... | CP | 1,000.00 | | 231.10 |
| | 27 | ..................... | P | | 1,071.40 | 1,302.50 |
| | 30 | ..................... | CP | 1,302.50 | | 0.00 |
| Nov. | 1 | ..................... | P | | 275.00 | 275.00 |
| | 12 | ..................... | P | | 1,651.40 | 1,926.40 |
| | | ..................... | J | | 151.20 | 2,077.60 |
| | 14 | ..................... | CP | 275.00 | | 1,802.60 |
| | 15 | ..................... | P | | 4,232.00 | 6,034.60 |
| | 17 | ..................... | P | | 54.70 | 6,089.30 |
| | 18 | ..................... | CP | 1,802.60 | | 4,286.70 |
| | 19 | ..................... | P | | 1,142.90 | 5,429.60 |
| | 23 | ..................... | CP | 4,232.00 | | 1,197.60 |
| | 22 | C/m................. | J | 721.40 | | 476.20 |
| | 27 | ..................... | P | | 100.00 | 576.20 |
| | | ..................... | CP | 521.50 | | 54.70 |
| | 30 | C/m................. | J | 24.50 | | 30.20 |
| | 25 | ..................... | P | | 160.50 | 190.70 |
| Dec. | 4 | ..................... | P | | 428.10 | 618.80 |
| | 6 | ..................... | P | | 261.00 | 879.80 |
| | 12 | ..................... | P | | 1,147.70 | 2,027.50 |
| | | ..................... | CP | 1,812.30 | | 215.20 |
| | 15 | ..................... | P | | 226.50 | 441.70 |
| | 18 | C/m................. | J | 226.50 | | 215.20 |
| | 22 | ..................... | P | | 174.30 | 389.50 |
| | 29 | ..................... | P | | 90.40 | 479.90 |

The statement of Evans, Fenwitz & Company on December 31, 19—, however, shows a balance due of $567.66. Being unable to reconcile this figure with the above balance of $479.90, a telephone request is made for an itemized statement of account; accordingly, Evans, Fenwitz & Company forward the following transcript of their account receivable with the J. Edwin Hart Company:

J. EDWIN HART COMPANY

| | | | | | | |
|---|---|---|---|---|---|---|
| Oct. | 22 | 2/10, n/30............ | S | 1,231.10 | | 1,231.10 |
| | 25 | ..................... | CR | | 1,000.00 | 231.10 |
| | 27 | 2/10, n/30............ | S | 1,071.40 | | 1,302.50 |
| Nov. | 1 | 2/10, n/30............ | S | 275.00 | | 1,577.50 |
| | | ..................... | CR | | 1,302.50 | 275.00 |
| | 12 | 2/10, n/30............ | S | 1,651.40 | | 1,926.40 |
| | | Freight prepaid........ | CP | 151.20 | | 2,077.60 |
| | 15 | 5/10, n/30........... | S | 4,232.00 | | 6,309.60 |
| | | ..................... | | | 269.50 | 6,040.10 |
| | 17 | 2/10, n/30............ | S | 54.70 | | 6,094.80 |
| | 19 | 2/10, n/30............ | S | 1,142.90 | | 7,237.70 |
| | 20 | ..................... | CR | | 1,799.58 | 5,438.12 |
| | 22 | C/m, invoice Nov. 15.. | J | | 721.40 | 4,716.72 |
| | 24 | ..................... | CR | | 4,195.93 | 520.79 |
| | 25 | net.................. | S | 160.50 | | 681.29 |
| | 27 | 2/10, n/30............ | S | 100.00 | | 781.29 |
| | 29 | C/m, invoices Nov. 19, 27 | J | | 521.50 | 259.79 |
| | 30 | C/m, invoice Nov. 1... | J | | 24.50 | 235.29 |
| Dec. | 4 | 2/10, n/30............ | S | 428.10 | | 663.39 |
| | 6 | 2/10, n/30............ | S | 261.00 | | 924.39 |
| | 12 | 2/10, n/30............ | S | 1,147.70 | | 2,072.09 |
| | 14 | Invoices, Dec. 4, 6, 12... | CR | | 1,812.30 | 259.79 |
| | 15 | 2/10, n/30............ | S | 226.50 | | 486.29 |
| | 18 | C/m, invoice Dec. 15... | J | | 226.50 | 259.79 |
| | 22 | 2/10, n/30............ | S | 174.30 | | 434.09 |
| | 29 | 2/10, n/30............ | S | 90.40 | | 524.49 |
| | 30 | 2/10, n/30............ | S | 43.06 | | 567.55 |

**Required:**

(1) Prepare a reconciliation of the two accounts.

(2) What valuation would you place on the liability in favor of Evans, Fenwitz & Company for balance-sheet purposes?

(3) Are creditors' statements useful in audit programs? Explain carefully.

(4) In general, how should the accounts payable of a business be verified?

## Southern Electrical Supply Company

The Southern Electrical Supply Company was a wholesaler of a line of electrical supplies. Some of its merchandise was purchased from the Packard Electric & Manufacturing Company, Brooklyn, N.Y. The account with this vendor had not proved satisfactory, and friction over remittances was common. As of December 31, 19—, it was decided that the account (shown below) should be paid in full, but, in doing so, it was necessary to specify on the remittance advice just what was being paid.

PACKARD ELECTRIC & MANUFACTURING COMPANY

| | | | | | |
|---|---|---|---|---|---|
| Jan. | 10 | | | 20,000.00 | 20,000.00 |
| | 16 | | | 285.29 | 20,285.29 |
| | 27 | | | 1,500.00 | 21,785.29 |
| Feb. | 12 | | | 52.77 | 21,838.06 |
| | 18 | | | 125.00 | 21,963.06 |
| | 28 | | | 2,088.06 | 24,051.12 |
| Mar. | 1 | | | 9.10 | 24,060.22 |
| | 16 | | | 11.00 | 24,071.22 |
| | 23 | | | 4,300.00 | 28,371.22 |
| Apr. | 3 | | | 6,000.00 | 34,371.22 |
| | 9 | | | 1,108.38 | 35,479.60 |
| | 16 | | | 1,600.00 | 37,079.60 |
| | 24 | | | 50.00 | 37,129.60 |
| | 25 | | 1,838.06 | | 35,291.54 |
| May | 10 | | | 1,200.00 | 36,491.54 |
| | 22 | | | 1,344.23 | 37,835.77 |
| June | 16 | | | 250.00 | 38,085.77 |
| | 19 | | | 361.17 | 38,446.94 |
| | 27 | | | 3,750.69 | 42,197.63 |
| July | 6 | | | 1,727.27 | 43,924.90 |
| | 12 | | 10,300.00 | | 33,624.90 |
| | 13 | | | 6,329.00 | 39,953.90 |
| | 29 | | | 484.87 | 40,438.77 |
| Aug. | 3 | | | 3,500.00 | 43,938.77 |
| | 18 | | | 61.88 | 44,000.65 |
| | 29 | | 22,233.16 | | 21,767.49 |
| | 31 | | | 3,018.03 | 24,785.52 |
| Sept. | 12 | | | 2,600.00 | 27,385.52 |
| | 12 | | 61.88 | | 27,323.64 |
| | 20 | | | 250.00 | 27,573.64 |
| | 26 | | | 3,050.00 | 30,623.64 |
| Oct. | 9 | | | 1,123.00 | 31,746.64 |
| | 10 | | 3,018.03 | | 28,728.61 |
| | 15 | | | 1,500.00 | 30,228.61 |
| | 20 | | | 100.51 | 30,329.12 |
| | 27 | | | 1,145.25 | 31,474.37 |
| Nov. | 7 | | | 760.00 | 32,234.37 |
| | 10 | | 3,500.00 | | 28,734.37 |

PACKARD ELECTRIC & MANUFACTURING COMPANY (Cont.)

| | | | | | |
|---|---|---|---|---|---|
| Nov. | 12 | | | 219.73 | 28,954.10 |
| | 20 | | 2,850.00 | | 26,104.10 |
| | 30 | | | 190.00 | 26,294.10 |
| Dec. | 2 | | | 3,790.99 | 30,085.09 |
| | 5 | | 22.86 | | 30,062.23 |
| | 6 | | 51.64 | | 30,010.59 |
| | 10 | | 219.73 | | 29,790.86 |
| | 12 | | | 1,350.00 | 31,140.86 |
| | 15 | | 443.24 | | 30,697.62 |
| | 20 | | 17,762.37 | | 12,935.25 |
| | 21 | | | 3,297.86 | 16,233.11 |

All credits in the account were for invoices; all debits in the account were for checks except for the two items of $22.86 and $51.64. These were credit memoranda.

**Required:**

Analyze the above account and prepare a list of the items comprising the balance of $16,233.11.

## Dwyer-Shevlin Corporation

During your examination of the voucher register of the Dwyer-Shevlin Corporation, you noticed a monthly voucher for $5,000.00 in favor of the Diamond Manufacturing Company. Your inquiries developed the information that, on April 1 of the audit (calendar) year, the company had contracted with the Diamond Manufacturing Company for the purchase of an intricate machine shown on the invoice at $105,263.15 (terms 5/30, n/90). However, the parties agreed on a conditional sales contract calling for a cash payment of $5,000.00 on April 1, and monthly payments of $5,000.00 thereafter, title to pass with the last payment. Nine such payments had been made and debited to the Machinery account. When you indicated your intention to show the unpaid balance as a liability on the balance sheet, officers of the company objected vehemently. The machinery was not theirs, they said, until it had been paid for in full. The only asset which they had at the moment was their equity of $45,000.00 representing the nine payments made to date.

**Required:**

(1) Should the liability appear on the balance sheet? Why? At what valuation?

(2) At what gross value should the machinery be capitalized? Why? On what value should depreciation for the nine months be calculated?

(3) How should this contract be reflected in the balance sheet of the Diamond Manufacturing Company?

(4) Would you reason similarly with respect to automobiles sold under similar arrangements? When may an automobile dealer be said to earn income on automobiles sold under conditional bills of sale?

## Lynstons', Inc.

On December 31, 19—, the balance of the Notes Payable account, $230,000.00, of Lynstons', Inc., consisted of the following notes, on which no interest has been paid:

| *Payee* | *Dated* | *Term* | *Interest* | *Face* | *Remarks* |
|---|---|---|---|---|---|
| Ballard, Carl J. | Nov. 12 | 3 mo. | 4½% | $ 11,000.00 | Trade creditor. |
| Daly, Mark R. | Oct. 16 | 4 mo. | 4% | 5,000.00 | " " |
| First National Bank | Oct. 1 | 3 mo. | 0 | 60,000.00 | Discounted Oct. 1 at 4%. Secured by pledge of 100,000 shares of the company's unissued capital stock. |
| Lynston-Lenit Co. | Oct. 1 | 5 yrs. | 6% | 40,000.00 | A 40% owned subsidiary of Lynstons', Inc. |
| Lynston Manufacturing Co. | July 1 | 5 yrs. | 5% | 50,000.00 | A 70% owned subsidiary of Lynstons', Inc. |
| Lynston Sales Co. | Apr. 1 | 5 yrs. | 4% | 30,000.00 | A 100% owned subsidiary of Lynstons', Inc. |
| Meredith, Mark L. | Dec. 14 | 2 mo. | 4% | 6,000.00 | Trade creditor. |
| Simmons, James L. | Sept. 8 | 5 mo. | 5% | 8,000.00 | Trade creditor. |
| Wheeler, L. J. | Jan. 1 | 5 yrs. | 3% | 20,000.00 | Payee is a vice-president of Lynstons', Inc. |
| | | | | $230,000.00 | |

All of the above notes were issued during the current audit year. The three notes in favor of the three Lynston affiliates were discounted by the payees. Three days after the close of the audit year, you find that the company accepted a 60-day sight draft (in favor of Delta Specialties Corporation) covering merchandise shipped December 27, f.o.b. shipping point. The shipment was forwarded "60-day sight draft, order bill of lading attached" for $20,000.00.

**Required:**

(1) Prepare working papers for the above account showing all steps that you would deem necessary for a satisfactory audit.

(2) How would you present these notes on the balance sheet?

## Nichols Surgical Supply Company

During the course of your examination of the cash of the Nichols Surgical Supply Company on December 31, 19—, you observe on the confirmation received from the Commerce National Bank & Trust Company that your client is indebted to the bank for a 6% note on which the unpaid balance is $4,949.03.

You find that your client purchased a 5-year insurance policy on October 1 of the audit year, the lump sum premium being $5,198.42; that $100.00 cash was paid immediately and that the balance of $5,098.42 was financed by a note payable in favor of the bank calling for a payment to the bank of $100.00 on the first day of each month. Your client made these payments on November 1 and December 1, debiting Insurance Expense.

However, the note itself was not recorded on the books nor was there any Prepaid Insurance account.

**Required:**

(1) What are the auditor's adjustments, if any?

(2) How should the above expenditures be classified and valued in the balance sheet and income statement?

(3) What are the main steps of verification to be followed in this case?

## Cosco & Kirby, Inc.

During your audit of Cosco & Kirby, Inc., produce jobbers and wholesalers, for the fiscal year ending December 31, 19—, you find the following tax accounts on the ledger:

PREPAID TAXES

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Jan. | 1 | Estimated taxes for the year | J | 15,462.72 | Jan. | 31 | J | 1,288.56 |
| | | | | | Feb. | 28 | J | 1,288.56 |
| | | | | | Mar. | 31 | J | 1,288.56 |
| | | | | | Apr. | 30 | J | 1,288.56 |
| | | | | | May | 31 | J | 1,288.56 |
| | | | | | June | 30 | J | 1,288.56 |
| | | | | | July | 31 | J | 1,288.56 |
| | | | | | Aug. | 31 | J | 1,288.56 |
| | | | | | Sept. | 30 | J | 1,288.56 |
| | | | | | Oct. | 31 | J | 1,288.56 |
| | | | | | Nov. | 30 | J | 1,288.56 |
| | | | | | Dec. | 31 | J | 1,288.56 |

TAXES PAYABLE

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Feb. | 1 | Real estate tax | CP | 1,187.84 | Jan. | 1 | Estimated taxes for the year | J | 15,462.72 |
| | 1 | Real estate tax | CP | 541.33 | | | | | |
| Apr. | 1 | Personal property tax | CP | 948.60 | | | | | |

TAXES EXPENSE

| | | | | |
|---|---|---|---|---|
| Jan. | 31 | J | 1,288.56 | |
| Feb. | 28 | J | 1,288.56 | |
| Mar. | 31 | J | 1,288.56 | |
| Apr. | 30 | J | 1,288.56 | |
| May | 31 | J | 1,288.56 | |
| June | 30 | J | 1,288.56 | |
| July | 31 | J | 1,288.56 | |
| Aug. | 31 | J | 1,288.56 | |
| Sept. | 30 | J | 1,288.56 | |
| Oct. | 31 | J | 1,288.56 | |
| Nov. | 30 | J | 1,288.56 | |
| Dec. | 31 | J | 1,288.56 | |

All taxes due for payment in the preceding calendar year had been paid. Based on these payments, the entry on January 1 in the above accounts covered taxes for the coming year, as follows:

| | | |
|---|---|---|
| Real estate taxes (city)....... | $ 1,187.84 | Due February 1 for current calendar year. |
| " " " " ....... | 533.27 | " " " " " " " |
| " " " (county).... | 297.93 | " " " " " " " |
| Personal property taxes...... | 943.68 | " " " " " " " |
| Franchise tax............... | 500.00 | " December 1 for next calendar year. |
| Income taxes............... | 12,000.00 | " March 15 of next calendar year. |
| | $15,462.72 | |

The company paid no income tax on March 15 of the current calendar year because it reported a small net loss for the tax year involved. You calculate income taxes for the current calendar year to be $15,106.17.

**Required:**

(1) Audit working papers for these tax accounts, December 31, 19—. Include on these working papers the main steps of your audit program for these accounts.

(2) If you were preparing interim statements as of June 30, 19—, how would the above accounts appear on your statements?

## Fairmont Manufacturing Company

During your audit of the accounts of the Fairmont Manufacturing Company for the past calendar year, you examine the following tax accounts as of December 31, 19—:

WITHHOLDING INCOME TAXES PAYABLE

| | | | |
|---|---|---|---|
| | Dec. 1–28 | | 5,083.30 |

The income tax withholdings of each month are paid by the company to the Central National Bank on the tenth of the following month.

WITHHOLDING O.A.B. TAXES PAYABLE

| | | | |
|---|---|---|---|
| | Dec. 28 | Balance | 1,730.02 |

STATE UNEMPLOYMENT TAXES PAYABLE (2.7%)

| | |
|---|---|
| | |

U.S. UNEMPLOYMENT TAXES PAYABLE (0.3%)

| | |
|---|---|
| | |

WAGES EXPENSE

| | | | |
|---|---|---|---|
| Jan. 1 to Sept. 30 | VP | 214,710.28 | |
| Oct. 1 to Nov. 30 | VP | 61,084.62[1] | |
| Dec. 1–28 | VP | 25,416.50[2] | |

[1] Including wages cumulatively in excess of $3,000.00 for the year to date, said excess wages occurring in the fourth quarter of the year. The amount of this excess (in the period Oct. 1–Nov. 30) was $9,603.00.

[2] Including wages cumulatively in excess of $3,000.00 for the year to date, said excess wages occurring in the fourth quarter of the year. The amount of this excess (in the period Dec. 1–28) was $3,111.02.

The accrued payroll for the period December 29–31 is $4,341.10. Included in this payroll are "wages in excess of $3,000.00" amounting to $416.50.

**Required:**

(1) What should be the correct balances of the above accounts for inclusion in the current liability section of your audited balance sheet for December 31? For this purpose use O.A.B. rates of 2%, unemployment rates of 3%, and an average withholding income tax rate of 20%.

(2) What are the auditor's adjusting entries?

(3) What are the important steps to be taken in the audit of these accounts?

(4) If the accrued payroll December 29–31 were "constructively receivable" by employees, what should be the correct balances of the accounts above? Show the auditor's adjusting entries.

## Horace J. Hardeman

On December 31, 1953, the ledger of Horace J. Hardeman, a merchant, showed Taxes Expense with a balance of $20,640.00, and Taxes Payable, $13,000.00. These balances consisted of the following detail:

TAXES EXPENSE

| | | | | | |
|---|---|---|---|---|---|
| 1953 | | | | | |
| Mar. 15 | Income tax for 1952 | 6,000.00 | | | |
| May 1 | Property taxes | 7,890.00 | | | |
| Jan. to Dec. | Twelve sales tax remittances to State Treasurer | 6,750.00 | | | |

TAXES PAYABLE

| | | | | | |
|---|---|---|---|---|---|
| | | | 1952 | | |
| | | | Dec. 31 | Estimated accrued property taxes for eight months | 5,000.00 |
| | | | 31 | Sales tax for December 1952 | 500.00 |
| | | | 31 | Provision for 1952 income taxes | 7,500.00 |

The bookkeeper debited all disbursements for taxes to the Taxes Expense account. The disbursement on May 1, 1953, for $7,890.00 covered property taxes for the tax year, May 1, 1952, to April 30, 1953. On May 1, 1952, the payment for property taxes was $7,500.00. The property tax bill for the year ending April 30, 1954, was estimated at $8,490.00.

Sales taxes collected (or debited to accounts receivable) were credited to the Sales account as a matter of bookkeeping convenience. The total sales tax collected from or debited to trade customers in any given month was remitted to the State Treasurer by the 20th of the next succeeding month. The sales taxes of $562.50 relating to the sales of December, 1953, were remitted to the State Treasurer on January 15, 1954. The offsetting debit for the credit of $500.00 in the Taxes Payable account was the Sales account.

Due to the fact that the preliminary profit and loss statement for 1953 showed a small net loss of $965.00, no income tax was expected to be payable for the year 1953.

**Required:**

(1) What adjusting entries, relating to the two tax accounts illustrated above, should be placed on the audit working papers?

(2) What should be the debit (or debits) for taxes on the profit and loss statement of Mr. Hardeman for the year 1953?

(3) What minimum essentials should be included in the audit program for the examination of these two accounts?

# 12. LONG-TERM LIABILITIES

## Goodwin & Company, Inc.

On January 1, last year, Goodwin & Company, Inc., owed $1,000,000.00 par value of $4\frac{1}{2}\%$ debenture notes payable due annually as follows: $100,000.00 in one year, $200,000.00 in two years, $300,000.00 in three years, and $400,000.00 in four years. The unamortized discount on these notes payable on January 1 was $50,000.00. Interest was payable each January 1.

The one-year notes were paid on their due date and, on the date of the payment of these notes, the company also redeemed $100,000.00 par value of the notes of four-year maturity at a price of 105.

**Required:**

Give all of the accounting entries affecting the notes payable, interest, and discount accounts of the year in which the above redemptions occurred. On December 31 of this same year, how should the outstanding notes payable be classified and valued on the balance sheet?

## Shaw Milling Company

Your audit of the Shaw Milling Company for the year 1954 includes an examination of the following accounts whose balances on December 31, 1954, were:

6% 10-Year Bonds Payable, Due January 1, 1960

| | | | | | |
|---|---|---|---|---|---|
| | | | 1950 | | |
| | | | Jan. 1 | CR | 1,000,000.00 |

Bond Discount

| | | | | | |
|---|---|---|---|---|---|
| 1950 | | | | | |
| Jan. 1 | CR | 40,000.00 | | | |

Bond Interest Expense

| | | | | | |
|---|---|---|---|---|---|
| 1954 | | | 1954 | | |
| Jan. 1 | CP | 30,000.00 | Jan. 1 | J | 30,000.00 |
| July 1 | CP | 30,000.00 | | | |

The following disbursement of December 31, 1954, has not yet been recorded: $100,000.00 par value of the above bonds were acquired at a price of 90.

**Required:**

(1) What are the correct balances of the above accounts for placement in the statements of 1954?

(2) What are the auditor's adjusting entries?

(3) How should the balances of these accounts be verified?

## Blake Belting Company

On December 31, 19— (this year), the condensed trial balance of the Blake Belting Company was as follows:

| | | |
|---|---|---|
| Sundry Assets | $4,394,447.00 | |
| Accounts Payable | | $ 327,256.00 |
| 6% 10-year Debenture Bonds Payable | | 1,000,000.00 |
| Unamortized Bond Discount | 92,800.00 | |
| Treasury Bonds | 70,500.00 | |
| Common Stock, $100.00 par | | 2,000,000.00 |
| Earned Surplus | | 1,184,353.00 |
| Sales | | 4,831,774.00 |
| Cost of Sales | 3,024,520.00 | |
| Sundry Operating Expenses | 1,733,366.00 | |
| Bond Interest Expense | 27,750.00 | |
| | $9,343,383.00 | $9,343,383.00 |

The bonds payable were issued on January 1, 19— (last year), at an average issue price of 90.72. On January 1 of the current year, the company purchased its own bonds in the par value of $75,000.00 at an average price of 94. The bookkeeper recorded the disbursement as follows:

| | | |
|---|---|---|
| Treasury Bonds | 70,500.00 | |
| Cash | | 70,500.00 |
| To record purchase of bonds. | | |

**Required:**

(1) Profit and loss statement for the current year.

(2) Balance sheet, December 31, 19—

## Wingate Iron Works, Inc.

During your annual audit of the accounts of the Wingate Iron Works, Inc., for the past calendar year, the following five accounts appear as follows in the ledger, December 31, 19—:

**BONDS PAYABLE**

| | | | | | |
|---|---|---|---|---|---|
| | | | 19— | | |
| | | | Jan. 1 | Balance | 10,000.000.00 |

**TREASURY BONDS PAYABLE**

| | | | | | |
|---|---|---|---|---|---|
| 19— | | | | | |
| Jan. 1 | CP1 | 1,000,000.00 | | | |

**DISCOUNT ON BONDS PAYABLE**

| | | | | | |
|---|---|---|---|---|---|
| 19— | | | 19— | | |
| Jan. 1 | Balance | 200,000.00 | Dec. 31 | J69 | 12,500.00 |

**GAIN ON TREASURY BONDS PAYABLE**

| | | | | | |
|---|---|---|---|---|---|
| | | | 19— | | |
| | | | Jan. 1 | CP1 | 100,000.00 |

**BOND INTEREST AND DISCOUNT EXPENSE**

| | | | | | |
|---|---|---|---|---|---|
| 19— | | | | | |
| July 1 | CP73 | 180,000.00 | | | |
| Dec. 31 | J69 | 12,500.00 | | | |

You find that the Wingate Iron Works, Inc., originally issued $10,000,000.00 of 4% 40-year debenture bonds payable at 95, interest payable January 1 and July 1. The present bond liability (as of December 31 of the audit year) has been outstanding for 25 calendar years. On January 1 of the year under audit, the company purchased $1,000,000.00 par value of its own bonds payable at an average price of 90.

**Required:**

What adjusting entries should be made affecting these accounts? How should the bonds payable appear in the balance sheet, December 31 of the audit year? What are the major points to be included in the audit program for these accounts?

## Cassatt-Dyer Tobacco Company

During your audit of the accounts of the Cassatt-Dyer Tobacco Company for the year 1952, the following accounts relating to the long-term liabilities of the company were examined:

5% Debenture Bonds Payable, Due January 1, 1972

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 1952 | | | | 1942 | | | |
| Jan. 1 | | CP1 | 4,000,000.00 | Jan. 1 | | CR1 | 4,000,000.00 |

Discount on Bonds Payable of 1972

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 1952 | | | | | | | |
| Jan. 1 | Balance | | 120,000.00 | | | | |

Premium on Redemption of Bonds Payable of 1972

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 1952 | | | | | | | |
| Jan. 1 | | CP1 | 100,000.00 | | | | |

3% Debenture Bonds Payable, Due January 1, 1982

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | 1952 | | | |
| | | | | Jan. 1 | | CR1 | 5,000,000.00 |

Discount on Bonds Payable of 1982

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 1952 | | | | | | | |
| Jan. 1 | | CR1 | 200,000.00 | | | | |

Refunding Expenses on Bonds Payable of 1972 and 1982

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 1952 | | | | | | | |
| Feb. 9 | | CP17 | 20,000.00 | | | | |

**Required:**

Prepare audit working papers to show how these accounts should appear in the audited financial statements for 1952. What should be the audit program for the examination of these accounts?

## The Bonder Corporation

Five years ago, on January 1, 19—, The Bonder Corporation issued \$1,000,000.00 of 15-year 5% debenture bonds payable, interest payable January 1 and July 1. The trust indenture for the bonds included the following provisions:

A fund for the redemption of the bonds shall be created by setting aside each year a sum equal to 10% of the audited net income of that year (after taxes) but excluding, however, any income which may be earned by the fund or by income arising out of the trustee's purchase of bonds of The Bonder Corporation. These annual sums—which are not to be more than \$100,000.00 nor less than \$25,000.00 for any one year—shall be paid to the Merchants' National Bank, as trustee, within three months after the close of the company's fiscal year. As of December 31 of each year, furthermore, a sinking fund reserve shall be created by annual reservations from each year's net income of an amount equal to the company's expected payment to the trustee in the ensuing three months.

No dividends shall be paid from the earned surplus (\$2,321,000.00) existing as of the date of the issuance of the bonds payable. Dividends in any one year, if any, shall be limited to 50% of the net-income-base upon which the 10% annual disbursement to the trustee is calculated.

At the end of the fifth year the only accounts on the ledger relating to the bond issue are: Bonds Payable, \$1,000,000.00; Bond Interest Payable, \$25,000.00; Bond Fund, \$153,150.00.

Audited net income (before giving effect to income earned by the bond fund) of the company for the past five years has been, successively: \$380,000.00; \$440,000.00; \$630,000.00; \$250,000.00, and (\$497,000.00) for last year. Cash dividends of 5% on capital stock of \$4,000,000.00 par have been paid annually since the inauguration of dividends 10 years ago.

For the five-year period the Merchants' National Bank reports on the fund in its possession as follows:

| *Date of Transaction* | *Cash Received* | *Interest Earned* | *Total* |
|---|---|---|---|
| 1st year | | | |
| 2nd year | \$38,000.00 | \$1,150.00 | \$ 39,150.00 |
| 3rd year | 44,000.00 | 2,500.00 | 85,650.00 |
| 4th year | 63,000.00 | 4,500.00 | 153,150.00 |
| 5th year | | 4,600.00 | 157,750.00 |

**Required:**

(1) How should the above accounts and information be reflected and classified in the audited statements for the fifth year? What questions of auditing principle does this case raise? What points should be covered in the audit program?

(2) What entries should be placed on the auditor's working papers? What entries or recommendations should be given to the auditor's client?

(3) How would your audited financial statements be altered if the trustee's sinking fund was found to include $100,000.00 par value bonds of The Bonder Corporation?

## Farman-Baker Corporation

You are making your first audit of the Farman-Baker Corporation for the calendar year of 1955. On December 31, 1955, the following accounts, among others, are found on the ledger:

5%, 20-Year, Bonds Payable, Due January 1, 1968, Interest Payable January 1 and July 1

| | | | | | |
|---|---|---|---|---|---|
| | | | 1948 | | |
| | | | Jan. 1 | CR | 10,000,000.00 |

Bond Premium

| | | | | | |
|---|---|---|---|---|---|
| | | | 1948 | | |
| | | | Jan. 1 | CR | 400,000.00 |

Bonds Payable in Treasury

| | | | | | |
|---|---|---|---|---|---|
| 1955 | | | | | |
| Dec. 31 200 M bonds bought at 100 | CP | 205,000.00 | | | |

People's National Bank, Trustee

| | | | | | |
|---|---|---|---|---|---|
| 1955 | | | | | |
| June 29 | CP | 250,000.00 | | | |
| Dec. 29 | CP | 250,000.00 | | | |

These two debits represent semiannual interest checks in favor of the People's National Bank, trustee for the bond issue and fiscal agent for the payment of the company's interest coupons.

Bond Interest Expense

| | | | | | |
|---|---|---|---|---|---|
| 1955 | | | | | |
| June 30 | J | 250,000.00 | | | |
| Dec. 31 | J | 250,000.00 | | | |

Bond Interest Payable

| | | | | | |
|---|---|---|---|---|---|
| | | | 1955 | | |
| | | | June 30 | J | 250,000.00 |
| | | | Dec. 31 | J | 250,000.00 |

You also ascertain that, when the bonds were issued originally, miscellaneous financial costs of $100,000.00 were incurred. These were paid and debited to Profit and Loss in 1948.

**Required:**

(1) Auditor's adjusting entries.

(2) How should the above bond accounts and Deferred Bond Expense (if any) be valued and classified on the balance sheet?

(3) What major verification steps should be recorded on the working papers for the above accounts?

# 13. SUNDRY AND CONTINGENT LIABILITIES

## Diamond Vending Corporation

During the course of your audit of the Diamond Vending Corporation, an examination of the balance of the Miscellaneous Expense account, $61,000.00, disclosed one charge of $12,000.00. This charge was supported by an invoice of the same amount, dated May 29, from Bruss & Evans, attorneys.

The president and vice-president of the company had initialed the invoice and approved it for payment with the pencil notation "retainer fee." This was the only information which you were able to obtain from any and all sources. You were not able to discover the existence of any contingent liabilities relating to this invoice and officers stated that "as of December 31, 19—," there were none.

There was also another invoice, dated October 17, from Collis & Hecht, certified public accountants, for $300.00 charged to Miscellaneous Expense. The treasurer of the company stated that this charge represented a partial bill from the accountants in representing the company before the Collector of Internal Revenue who had revised upward the company's income tax bill of two years ago by $18,000.00.

**Required:**

How should the above information be handled in the preparation of your audit report and financial statements?

## Wescot Refrigerator Company

The Wescot Refrigerator Company is a manufacturer and distributor of electrical refrigerators and other electrical appliances. Although not specifically itemized in its billings, the price of refrigerators to dealers and consumers included a $25.00 charge for a five-year warranty guaranteeing the product to be free from defects in workmanship and materials.

**Required:**

In the preparation of audited statements of income, and financial condition, how should the above $25.00 charge be handled for the Wescot Refrigerator Company?

## Home Food Products Company

The Home Food Products Company was a manufacturer and distributor of various kinds of oils for home cooking purposes. In February of this year you are auditing the accounts of the company for the past calendar year. Among other things you find that the company (in December) had entered into certain commitments (at fixed prices) for peanut, cottonseed, and other oils, deliveries to be made in the first six months of the next calendar year. You find, also, that prices on these oils had declined considerably in the first five weeks of the new calendar year and that recent prices were being described as "soft." The decline was large enough to suggest that the company would soon be obliged to revise downward its prices on its finished products. Officers of the company informally expressed the opinion that prices would probably be lowered "at least 10%."

**Required:**

(1) How would you handle this kind of circumstance in preparing the audited financial statements:

(a) If the December purchase commitments were about normal?

(b) If the December purchase commitments were much in excess of normal?

(2) Would your answers to these questions be altered if the company possessed firm sales contracts with customers substantially covering the purchase commitments described above?

## Jack & Bailey, Inc.

As of January 1, last year, Jack & Bailey, Inc., made effective a plan wherein employees might participate in the profits of the company by ownership of "Employee's Savings Certificates." These nonnegotiable (callable at 100) certificates were purchasable by employees at par ($100.00) with an indicated annual minimum return of 6% on par plus such extra return as directors might deem feasible. The annual return to be paid, however, was contingent and dependent upon declaration by the board of directors of the dividend to be paid on Employee's Savings Certificates.

Collections made on principal were refundable on demand and, after the certificates had been paid in full, the company promised to repurchase them at par, when, as, and if requested, at any time. Employee's Savings Certificates, owned by employees who severed their connection with the company, were immediately payable in full as of date of severance.

**Required:**

(1) How should the amount of certificates outstanding on December 31, 19—, be verified? How should the certificates be shown on the balance sheet if $100,000.00 of savings certificates were paid in full? If they were partially paid—say 40%? If they were only subscribed for and no payments received to date?

(2) Is the repurchase agreement of any interest to the auditor? Explain.

(3) How is the "interest expense" on these certificates to be classified—as an expense or as a dividend?

# 14. CAPITAL STOCK AND SURPLUS

## Ryan Motors, Inc.

On December 31, 19—, the Ryan Motors, Inc., had been in existence for exactly 12 months. On this date its net worth accounts were:

$6.00 PREFERRED STOCK, NO-PAR, AUTHORIZED 1,000 SHARES

| | | | | | |
|---|---|---|---|---|---|
| | | | Jan. 9 | 1,000 at 90 | 90,000.00 |

COMMON STOCK, NO-PAR, AUTHORIZED 5,000 SHARES

| | | | | | |
|---|---|---|---|---|---|
| Aug. 31 | 100 at 75, originally issued June 30 | 7,500.00 | Jan. 10 | 1,500 at 60 | 90,000.00 |
| | | | " 29 | 1,000 at 65 | 65,000.00 |
| Oct. 10 | 100 at 70, originally issued June 30 | 7,000.00 | Feb. 17 | 500 at 70 | 35,000.00 |
| | | | June 30 | 700 at 80 | 56,000.00 |

EARNED SURPLUS

| | | | | | |
|---|---|---|---|---|---|
| Dec. 15 | Preferred dividend | 6,000.00 | Dec. 31 | Net income | 11,200.00 |
| | Common dividend | 3,500.00 | | | |

**Required:**

(1) How should the above accounts appear in your audited balance sheet of December 31, 19—?

(2) What are the major steps to be followed in the verification of the values of the above accounts?

(3) If no dividends had been paid during the year, how would this have affected the balance sheet?

## Larned & Barker, Inc.

You are making an audit of the accounts of Larned & Barker, Inc., for the past calendar year. This is a first audit. The company has been in existence for two years. On December 31, 19—, the company's net worth accounts were:

COMMON STOCK, $100.00 PAR, AUTHORIZED 10,000 SHARES

| | | | | | |
|---|---|---|---|---|---|
| (this year) | | | (last year) | | |
| June 9 | 100 shares at 100, originally issued January 23, last year | 10,000.00 | Jan. 2 | 6,100 at 100 | 610,000.00 |
| | | | 4 | 2,000 at 105 | 200,000.00 |
| | | | 11 | 1,000 at 106 | 100,000.00 |
| | | | 23 | 500 at 110 | 50,000.00 |
| | | | (this year) | | |
| | | | Oct. 1 | 200 at 110, issued in payment of land for a new building | 20,000.00 |

SURPLUS

| | | | | | |
|---|---|---|---|---|---|
| (last year) | | | (last year) | | |
| Feb. 10 | Organization expenses | 3,000.00 | Jan. 4 | Premium on stock | 10,000.00 |
| Dec. 20 | 1½% cash dividend, payable Jan. 10 | 14,400.00 | 11 | " " " | 6,000.00 |
| (this year) | | | 23 | " " " | 5,000.00 |
| Mar. 15 | Income taxes for last year | 10,000.00 | Dec. 31 | Net income for year | 29,000.00 |
| July 9 | Additional income tax for last year, as per agreement with Collector of Internal Revenue | 1,000.00 | (this year) | | |
| Dec. 20 | 4% cash dividend, payable Jan. 10 | 38,800.00 | Oct. 1 | Premium on stock | 2,000.00 |
| 31 | To Reserve for Contingencies | 25,000.00 | Dec. 31 | Net income for year | 73,000.00 |

RESERVE FOR CONTINGENCIES

| | | | | | |
|---|---|---|---|---|---|
| | | | (this year) | | |
| | | | Dec. 31 | | 25,000.00 |

**Required:**

(1) Prepare working papers for the above accounts showing auditor's adjusting entries and, also, all major steps of verification.

(2) How should the above accounts appear on your audited balance sheet of December 31, 19—?

## Long Island Sales Company

During your audit of the Long Island Sales Company for the past calendar year, you found the following account on the general ledger:

CAPITAL STOCK (AUTHORIZED 5,000 SHARES $100.00 PAR)

| | | | | |
|---|---|---|---|---|
| 19— (current year) | | 19— (current year) | | |
| Aug. 31 | 6,000.00 | Jan. 1 | Balance | 469,000.00 |
| Oct. 19 | 4,000.00 | Feb. 1 | | 10,000.00 |
| | | Apr. 7 | | 9,000.00 |
| | | June 9 | | 8,000.00 |
| | | July 28 | | 3,000.00 |
| | | Aug. 12 | | 1,000.00 |

The company's bookeeper gave you the following summary of capital stock issued:

| *Ctf. No.* | *Date* | *Shares* | *Stockholder* |
|---|---|---|---|
| | (*previous year*) | | |
| 1 | | | This, not signed, was filed with the State Securities Commission. |
| 2 | Jan. 7 | 1,000 | John E. Baxter |
| 3 | Jan. 7 | 500 | John E. Baxter |
| 4 | Jan. 8 | 700 | C. Oliver Steadman |
| 5 | Jan. 10 | 600 | Earl A. Raymond |
| 6 | Jan. 17 | 500 | Robert A. Greene |
| 7 | Mar. 9 | 300 | Walter C. Evans |
| 8 | Mar. 21 | 165 | Victor J. Colway |
| 9 | Apr. 2 | 100 | Harvey T. Eaton |
| 10 | May 24 | | Void |
| 11 | June 6 | 100 | James D. Foreman |
| 12 | July 10 | 100 | Harmon C. Utley |
| 13 | July 25 | 100 | Edmond J. Long |
| 14 | Aug. 12 | 100 | Lincoln E. Kelley |
| 15 | Aug. 31 | 100 | Frank A. Boland |
| 16 | Sept. 5 | 75 | Alan M. Schuster |
| 17 | Oct. 27 | 50 | Herman L. Wescotten |
| 18 | Oct. 31 | 30 | Ralph E. Mulholland |
| 19 | Nov. 14 | 60 | Walter E. Dean |
| 20 | Nov. 26 | 70 | Ray C. Comer |
| 21 | Dec. 3 | 40 | Robert E. Hastings |
| | (*last year*) | | |
| 22 | Jan. 31 | 100 | Silas M. Berwitz |
| 23 | Mar. 12 | 90 | Jerome A. Nickson |
| 24 | May 7 | 80 | Clinton E. Bennett |
| 25 | July 30 | 30 | Albert A. Pearson |
| 26 | Aug. 19 | 10 | Jerome A. Nickson |
| | | 5,000 | |

All of the above certificates had been issued and had been paid in full with the exception of Ctf. #3 in favor of John E. Baxter, president of the company. The bookkeeper stated that the company held an "on demand" note of Mr. Baxter for $50,000.00, carrying the same date as the stock certificate.

Certificates #19 and #21 had been reacquired by the company from the stockholders named; the certificates had been endorsed but not cancelled, and then pledged by the company as collateral on a bank loan of $25,000.00 from the Eastwood State Bank.

**Required:**

Prepare working papers for the company's capital stock accounts, listing thereon all steps of verification that should be included in the audit of these accounts. How should be capital stock of the company appear on the audited balance sheet of December 31, 19—?

## Colway & Company, Inc.

The accounts of Colway & Company, Inc., were being audited for the past calendar year. On December 31, 19—, the general ledger showed balances on the following three accounts as follows:

6% Cumulative Preferred Stock, $100.00 par

| | | | | | | |
|---|---|---|---|---|---|---|
| June 20 | 1,000 shares | 90,000.00 | Jan. 1 | Balance | | 500,000.00 |

Common Stock, no-par, stated value $10.00

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | *Shares* | |
| | | | Jan. 1 | Balance | 50,000 | 2,000,000.00 |
| | | | July 1 | | 10,000 | 600,000.00 |

Surplus

| | | | | | |
|---|---|---|---|---|---|
| Mar. 20 | Preferred dividend | 7,500.00 | Jan. 1 | Balance | 1,500,000.00 |
| June 20 | Preferred dividend | 6,000.00 | Dec. 31 | Profits (after taxes) | 400,000.00 |
| Dec. 20 | Preferred dividend | 12,000.00 | | | |
| | Common dividend | 330,000.00 | | | |

Beginning with the year under current audit, you find that the charter of the company requires the establishment of a fund as well as a reserve for the ultimate redemption of the preferred stock. The year's provision for each is 10% of profits after taxes. As of December 31 neither the fund nor the reserve had been created.

**Required:**

(1) Are the balances of the above accounts correct? If not, how should they be adjusted?

(2) If no dividends had been paid during the year, how should the dividend arrearages appear on the balance sheet?

## W. E. Stillman & Company, Inc.

On December 31, 19— (last year), the general ledger accounts of this corporation included the following:

| | |
|---|---|
| 6% Preferred Stock, $100.00 par | $2,500,000.00 |
| Common Stock, $100.00 par | 5,000,000.00 |
| Treasury Stock, Common, 5,000 shares | 500,000.00 |
| Capital Surplus | 100,000.00 |
| Earned Surplus | 550,000.00 |

The capital surplus was created by the company's purchase of treasury stock during the past calendar year.

On December 31, 19— (last year), directors of the company declared cash dividends of 6% on the preferred stock and 5% on the common stock. These dividends have not yet been recorded.

**Required:**

What should the audit program be for the examination of these accounts? Is there any reason why the company's declaration of cash dividends on December 31, 19—, should be questioned by the auditor? Discuss.

## Cross & Burson, Inc.

The following accounts are found on the general ledger of Cross & Burson, Inc., December 31, 19—:

SUNDRY LIABILITIES

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | 19— (current year) | | | | |
| | | | Dec. | 31 | Audit fee for 19— | J | 3,000.00 |
| | | | | 31 | Franchise taxes, due for payment, Dec. 1, for following calendar year | J | 2,000.00 |
| | | | | 31 | Federal and state income taxes | J | 10,000.00 |
| | | | | 31 | Improvement taxes ($25,000.00) payable in 10 equal annual install-ments beginning Jan. 1 of the next calendar year | J | 2,500.00 |

DIVIDEND PAYABLE

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | 19— (current year) | | | | |
| | | | Dec. | 31 | (payable Jan. 20, 19—) | J | 20,000.00 |

COMMON STOCK (AUTHORIZED 5,000 SHARES, $100.00 PAR)

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| May 10 | 600 shares at cost | | 51,000.00 | 19— (current year) | | | |
| | | | | Jan. | 1 | Balance | 480,000.00 |
| | | | | Apr. | 1 | 200 shares sold at par | 20,000.00 |
| | | | | July | 1 | 100 shares sold at par | 10,000.00 |

EARNED SURPLUS

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | 19— (current year) | | | | |
| Dec. 31 | J | 20,000.00 | Jan. | 1 | Balance | | 13,000.00 |
| | | | Dec. | 31 | Profit for year, after estimated taxes | J | 23,000.00 |

**Required:**

(1) What entries would you place on your working papers to adjust the balances of these accounts?

(2) How would you classify and value these accounts on the balance sheet?

(3) What procedure should be followed by the auditor in establishing the propriety of the dividend?

## Frenslee Plastics Corporation

The following accounts appear in the general ledger of Frenslee Plastics Corporation on December 31, 19—:

$6.00 Preferred Stock, Cumulative, Convertible, no-par

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | 19— | | | |
| | | | | Jan. 1 | Balance, 10,000 shares | | 901,368.00 |
| | | | | July 1 | Raised to liquidating value of $100.00 per share | J39 | 98,632.00 |

Common Stock, no-par

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | 19— | | | |
| | | | | Jan. 1 | Balance, 30,000 shares | | 1,174,182.00 |

Earned Surplus

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 19— | | | | 19— | | | |
| June 30 | Preferred dividend | J38 | 30,000.00 | Jan. 1 | Balance | | 3,112,216.00 |
| | Common dividend | J38 | 37,500.00 | | | | |
| July 1 | To Preferred Stock | J39 | 98,632.00 | | | | |
| Dec. 31 | Preferred dividend | J74 | 15,000.00 | | | | |
| | Common dividend | J74 | 67,500.00 | | | | |

The entry of July 1, for $98,632.00, was placed on the books by direction of the president of the company, J. Harry Frenslee.

During the last six months of the year under audit, one-half of the preferred stock outstanding at the close of business July 1, 19—, was converted into 15,000 shares of common stock. Essentially these conversions occurred because of the larger cash dividends receivable by ownership of the common stock. Although the conversions had been handled properly by the company's secretary and treasurer, they were not formally recorded on the books of the company. Only a memorandum had been placed in the capital stock accounts by the company's accountant. The stock certificate books were correct.

**Required:**

How do you believe these accounts should be adjusted?

## Grace & Company

The following accounts appeared on the ledger of Grace & Company on December 31, 19—:

COMMON STOCK, AUTHORIZED 300,000 SHARES NO-PAR

| | | | | | |
|---|---|---|---|---|---|
| | | | | *Shares* | |
| | | Jan. 1 | Balance | 137,208 | 1,564,380.00 |
| | | Apr. 1 | | 100 | 1,200.00 |
| | | July 1 | | 10,000 | ? |
| | | Nov. 1 | | 3,692 | 53,534.00 |

TREASURY STOCK

| | | | | | |
|---|---|---|---|---|---|
| | *Shares* | | | *Shares* | |
| Feb. 10 | 5,000 | 50,000.00 | Oct. 15 | 5,000 | 75,000.00 |
| Dec. 15 | 1,000 | 15,000.00 | | | |

CAPITAL SURPLUS

| | | | | | |
|---|---|---|---|---|---|
| | | | Jan. 1 | Balance | 75,000.00 |

EARNED SURPLUS

| | | | | | |
|---|---|---|---|---|---|
| June 30 | Cash dividend | 71,154.00 | Jan. 1 | Balance | 1,311,410.00 |
| Dec. 31 | Cash dividend | 75,000.00 | Dec. 31 | Net income | 201,763.00 |

Supplementary information relating to these accounts was:

Feb. 10. A purchase of 5,000 shares of treasury stock was made at a cash cost of $50,000.00.

Apr. 1. A sale of 100 shares of no-par stock was made for cash, $1,200.00.

July 1. On this date some of the company's bondholders exercised their privilege of converting bonds into stock. Bonds of a par value of $100,000.00 were converted into 10,000 shares of no-par value capital stock. On this date Grace shares were selling in the open market at 11. On the preceding day, June 30, the balance of the 6% Bonds Payable account was $600,000.00, and Bond Discount, $18,000.00.

Oct. 15. The treasury stock (acquired February 10) was sold for cash, $75,000.00.

Nov. 1. A sale of 3,692 shares of no-par stock was made to the president of the company for cash, $53,534.00. The certificates for these shares of stock are still in the stock certificate book (all properly signed.)

Dec. 15. A purchase of 1,000 shares of treasury stock was made at a cash cost of $15,000.00.

Dec. 31. A stock dividend of 1 share for every 3 shares was declared, payable February 1, 19—.

**Required:**

(1) Prepare the net worth section as it would appear in your audited balance sheet, December 31, 19—.

(2) Prepare a detailed audit program for the above net worth accounts.

## Maple Publishing Company

On January 1, 19—, the net worth of the Maple Publishing Company consisted of 101,204 shares of no-par capital stock, $10,764,862.37; earned surplus, $31,608,379.16; and a reserve for contingencies, $10,000,000.00. These are audited figures. During the ensuing 12 months the following transactions affecting, or relating to, the net worth accounts of the company, occurred in the following order:

(1) The Reserve for Contingencies account was closed.

(2) A purchase of 1,204 shares of treasury stock was made for cash, $150,000.00.

(3) A stock dividend of 100% was paid on July 1, 19—.

(4) Cash dividends were paid in the second half of the year, amounting to $1,500,000.00.

(5) A stock dividend of 50% was declared on December 31, 19—.

(6) Profits for the year were $3,237,869.17. These profits did not include the company's proportionate share of the year's profits of a 72% owned subsidiary, the Maple Paper Company. The subsidiary's profits were $1,207,610.89 (audited figures); no dividends were declared or paid by this company. The investment of the Maple Publishing Company in its subsidiary was made on January 1 of the current year. The investment account was carried at cost.

**Required:**

(1) Prepare the net worth section of the Maple Publishing Company as it would appear on the audited unconsolidated balance sheet of December 31, 19—.

(2) Prepare an audit program for the net worth accounts of the Maple Publishing Company.

## Loft Soy Bean Products Company

During the course of your audit of the Loft Soy Bean Products Company for the past calendar year, you find the Reserve for Contingencies account for the year to be as follows:

| | |
|---|---|
| Balance, January 1, 19— | $1,000,000.00 |
| Extraordinary maintenance expenditures against which $500,000.00 had been set aside as a special credit to the Reserve for Contingencies account in the preceding calendar year | (471,000.00) |
| Recovery on securities written off as worthless seven years ago | 114,076.00 |
| Provision to reduce inventory of December 31, 19—, from a cost of $3,591,000.00 to market of $3,121,000.00 | 470,000.00[1] |
| Provision for possible future decline in value of inventory on hand, December 31, 19— | 500,000.00[1] |
| Provision for possible future decline on merchandise contracted for at a fixed price, delivery scheduled in the next calendar year | 100,000.00[1] |
| General provision created out of net income of current year | 500,000.00[2] |
| Appreciation in value of marketable securities (carried as current assets) | 211,019.00 |
| Balance, December 31, 19— | $2,424,095.00 |

[1] Offsetting debit: Earned Surplus.
[2] Offsetting debit: Profit and Loss, current audit year.

These particular entries were made by authority of the vice-president of accounting and finance. There was no authorization for these entries in the minute book, however.

**Required:**

How should the information contained in the Reserve for Contingencies account be reflected in the audited financial statements? What are the auditor's adjusting entries? The beginning balance of $1,000,000.00 may be accepted as correct.

## The Buy'N Sell Corporation

The Buy'N Sell Corporation operated a chain of 250 retail variety stores in which merchandise was sold at prices under $3.00.

In 1950, the company carried fire insurance on its stores; the annual premium amounted to $18,750.00. Beginning with January 1, 1951, the company decided to discontinue its insurance policies and, instead, to carry its own insurance. In accordance with this intention, the company decided to set up a Reserve for Fire Insurance account which would be credited annually with an amount equal to the premiums which otherwise would have been paid to private fire insurance companies. Insurance Expense was debited. The company also decided to establish a special fire insurance fund into which $12,500.00 would be placed on each December 31. This fund was placed with the First Trust Company at 3% annual interest. These payments were made regularly.

On January 1, 1952, the company opened 50 new stores and, on July 1, 1952, an additional 25 stores. On January 1, 1953, the company opened 50 more stores.

On October 31, 1953, a fire destroyed one of the stores, causing a loss of $25,000.00. Costs of reconstruction, amounting to $30,000.00, were paid on December 31, 1953.

**Required:**

For the audit year of 1953, what should be the balances of the accounts representing Insurance Expense, Reserve for Fire Insurance, and Loss on Fire, and the fire insurance fund? How should the Reserve for Fire Insurance be classified on the balance sheet?

# 15. INVESTIGATIONS, NEW FINANCING, ACCOUNTING COUNSEL

## Henry E. Stokes Company

During your audit of the Henry E. Stokes Company, the president of the company made the observation that he could not understand why the company was so cramped financially. The president, Mr. Stokes, stated that the company had earned a profit of $50,000.00 in the year just closed whereas in the previous year a loss of $12,000.00 had been incurred. In spite of this improvement, the company was reluctantly obliged to borrow quite heavily from the First National Bank.

Your condensed balance sheets were as follows:

| | | December 31 | |
|---|---|---|---|
| *Assets* | | *This Year* | *Last Year* |
| Cash | | $ 49,000.00 | $ 36,000.00 |
| Accounts Receivable | | 141,000.00 | 100,000.00 |
| Inventory | | 152,000.00 | 78,000.00 |
| U.S. Treasury Certificates | | 30,000.00 | 20,000.00 |
| Plant and Equipment | | 451,000.00 | 430,000.00 |
| Reserve for Depreciation | | (85,000.00) | (64,000.00) |
| | | $738,000.00 | $600,000.00 |
| *Equities* | | | |
| Accounts Payable | | $ 68,000.00 | $ 30,000.00 |
| Notes Payable | | 50,000.00 | 10,000.00 |
| Income Taxes Payable | | 20,000.00 | |
| Common Stock, $100.00 par | | 500,000.00 | 500,000.00 |
| Earned Surplus | | | 60,000.00 |
| January 1, this year | $ 60,000.00 | | |
| Net income, this year | 50,000.00 | | |
| | $110,000.00 | | |
| Dividends paid, this year | 10,000.00 | 100,000.00 | |
| | | $738,000.00 | $600,000.00 |

**Required:**

Prepare the section of your audit report which will answer the president's question. During 19— major repairs of $15,000.00 were debited to the Reserve for Depreciation.

## McCarthy & Robbins

Just prior to its dissolution, the trial balance of the ledger of the partnership of McCarthy & Robbins, December 31, 19—, was:

| | P & L Ratios This Year | P & L Ratios Last Year | | |
|---|---|---|---|---|
| Cash | | | $115,231.34 | |
| L. A. McCarthy, Capital | 60% | 75% | | $ 70,323.56 |
| F. S. Robbins, Capital | 40% | 25% | | 44,907.78 |
| | | | $115,231.34 | $115,231.34 |

Before disbursing the cash on hand, the partners call you in as an expert accountant to make a final review of the accounts of the business. You find only one significant error in the accounts, i.e., the ending inventory of December 31, 19— (a year ago), was recorded in the books at $112,995.35; it should have been $100,615.35.

For your services you are paid a fee of $500.00.

**Required:**

In journal entry form, show your recommendations for the distribution of cash to partners.

## State Street Sales Company

The accounts of the State Street Sales Company of Chicago were being audited for the year 1955. In the course of their examination the auditors found that the account receivable of Eakin, May & Company of Willow Falls, Illinois, had become uncollectible. The balance of this account on April 17, 1955, was $30,066.70. Of this balance $15,066.70 was written off on June 30 by a debit to the Reserve for Bad Debts. No sales were made to Eakin, May & Company during 1955.

The State Street Sales Company was able to recover some of the merchandise which it had sold to Eakin, May & Company. The sales invoice price of this recovered merchandise was $14,408.16; the gross profit on the sale was 32%.

The merchandise recovered was not returned to Chicago but was placed in a temporary store opened up by the State Street Sales Company in Willow Falls. No accounts were maintained for the transactions of the store.

From invoices, check books, and other sources of information, the following summary of transactions at the store was prepared:

| *Collections* | | *Disbursements* | |
|---|---|---|---|
| On sales of merchandise | $15,222.00 | To Chicago office | $10,000.00 |
| | | Rent | 300.00 |
| | | Wages | 840.00 |
| | | Purchase of merchandise | 2,017.62 |
| | | Miscellaneous expenses | 65.38 |

Unpaid sales invoices on December 31, 1955, amounted to $1,004.16; and unpaid purchases invoices, $782.41. The store inventory of merchandise had a cost value of $5,124.77.

On December 31, 1955, the account receivable with Eakin, May & Company appeared on the Chicago books as follows:

| | | | | |
|---|---|---|---|---|
| April 17 | 30,066.70 | June 30 | J | 15,066.70 |
| | | ....... | CR | 10,000.00 |

The Chicago books also showed Cost of Sales, $311,468.20, and inventory, December 31, 1955, of $62,406.19. These two account balances did not include values relating to the store at Willow Falls.

**Required:**

How would the above information influence the statements of the auditors? What adjusting entry should be placed on the working papers?

## Clarke Building Supplies Company

Karl J. Schwartz was in general charge of the office records of the Clarke Building Supplies Company. On July 1, 19—, auditors were scheduled to arrive for their interim examination of the company's accounts for the first six months of the current calendar year. On the evening of June 30, 19—, Mr. Schwartz disappeared. Not only did Mr. Schwartz take with him a considerable amount of company cash but he also appropriated, or destroyed, the cash receipts book, the cash payments book, the general ledger, and the check book. This was the condition of affairs when you arrived on the morning of July 1, 19—.

From various sources you assembled the following miscellaneous information:

*Transactions, January 1—June 30, 19—*

| | | |
|---|---|---|
| Sales on account, as per totals from sales books, for 6 months | | $1,012,614.77 |
| Sales for cash, as per totals of cash sales columns of sales books for 6 months | | 16,844.59 |
| The total of credits to accounts receivable for cash, January-June, amounted to | | 1,065,836.05 |
| Noncash credits to accounts receivable, as per total taken from subsidiary ledger | | 3,102.48 |
| Uncollected accounts receivable, as per total of accounts receivable subsidiary ledger, June 30, 19— | | 80,577.81 |
| Total of voucher register, for 6 months: | | |
| Merchandise purchases | $624,002.21 | |
| Expenses and payrolls | 321,189.66 | |
| Dividends | 10,000.00 | |
| Social security taxes | 1,580.24 | |
| Withholding income taxes | 21,518.27 | 978,290.38 |
| Unpaid vouchers, as per the voucher register, and file of unpaid bills, on June 30, 19—, amounted to | | 36,732.54 |
| Social security taxes paid to the Collector of Internal Revenue for January-March, $1,580.24. Social security taxes unpaid, as of June 30, 19—, $6,755.46. Of the total of $8,335.70, $1,667.14 represented social security taxes withheld from employees' paychecks. | | |
| Income taxes withheld from employees' paychecks amounted to $26,341.38. Of this sum, $21,518.27 had been remitted to the First National Bank, depository for the Collector of Internal Revenue. | | |
| Sale of junk materials to the Central Salvage Company, June 30, 19—, terms cash | | 300.00 |
| Cash in bank, after deduction of outstanding checks | | 58,333.72 |
| The petty cash fund could not be found. | | |
| Cash deposited in the bank, as per total of duplicate bank deposit slips, January-June, amounted to | | 983,480.64 |
| Inventory, June 30, 19— | | 66,984.41 |

The last available condensed balance sheet of the company, dated the preceding December 31, 19— was:

| *Assets* | | *Equities* | |
|---|---|---|---|
| Cash | $ 33,181.15 | Vouchers Payable | $ 18,770.23 |
| Petty Cash | 500.00 | | |
| Accounts Receivable | 138,901.57 | Capital Stock, $100.00 par | 200,000.00 |
| Inventory | 75,881.52 | Surplus | 41,672.42 |
| Plant Assets | 17,082.69 | | |
| Reserve for Depreciation, annual rate, 6% | (5,104.28) | | |
| | $260,442.65 | | $260,442.65 |

**Required:**

(1) Calculation and detailed explanation of the shortage of Mr. Schwartz.

(2) Statement of income, January 1, 19— to June 30, 19—. The defalcation of the cashier (who was not bonded) is to be shown as a special charge against income.

(3) Balance sheet, June 30, 19—.

## Remington Drug Company

On December 31, 19—, the balance sheet of the Remington Drug Company was as follows:

*Assets*

| | | | | |
|---|---|---|---|---|
| Current Assets: | | | | |
| Cash | | | | $ 50,000.00 |
| Accounts Receivable | | | | 115,000.00 |
| Inventories | | | | 225,000.00 |
| | | | | $390,000.00 |
| Fixed Assets: | | | | |
| | *Cost* | *Reserve* | *Net* | |
| Miscellaneous Equipment | $110,000.00 | $30,000.00 | $ 80,000.00 | |
| Buildings | 80,000.00 | 10,000.00 | 70,000.00 | |
| Land | 10,000.00 | | 10,000.00 | |
| | $200,000.00 | $40,000.00 | $160,000.00 | 160,000.00 |
| Intangible Assets: | | | | |
| Goodwill | | | | 100,000.00 |
| | | | | $650,000.00 |

*Equities*

| | | |
|---|---|---|
| Current Liabilities: | | |
| Accounts Payable | | $150,000.00 |
| Notes Payable | | 100,000.00 |
| | | $250,000.00 |
| Capital: | | |
| 7% Cumulative Preferred Stock, $100.00 par (dividend arrearages, $31.50 per share) | $100,000.00 | |
| Common Stock, $100.00 par | 100,000.00 | |
| Earned Surplus | 200,000.00 | 400,000.00 |
| | | $650,000.00 |

The company was unable to meet all of its currently maturing obligations and, pursuant to an agreement subsequently entered into with creditors and stockholders, a general plan of financial reorganization was decided upon, March 31, 19—. The main points of this plan were as follows:

(1) To improve the current position of the company, an issue of $50,000.00 fifteen-year, $5\frac{1}{2}\%$ first mortgage bonds on the real estate was to be marketed, the proceeds of which were to be ratably applied in the payment of current liabilities outstanding on December 31, 19—. The cash proceeds of the bond issue were to be $50,000.00 to the company.

(2) Of the remaining liabilities, $100,000.00 was to be converted into new 6% cumulative preferred stock, $100.00 par, redeemable at 100 at any time, and $100,000.00 was to be converted into new 6% notes payable, due serially at the rate of $10,000.00 annually, the first payment to be payable on January 1, next.

(3) The present 7% preferred stock was to be converted into new common stock at the rate of 10 shares of new common ($10.00 par) for each share of preferred.

(4) The present common stock was to be converted into new common stock at the rate of 10 shares of new common ($10.00 par) for each 10 shares of old common.

(5) Goodwill was to be written off.

**Required:**

(1) Balance sheet giving effect to a plan of financial reorganization.

(2) Is it proper for a professional accountant to prepare this kind of statement? Would it be proper for him to give an "opinion" on the balance sheet?

## Harlan P. Fiske

Mr. Harlan P. Fiske was a retired businessman residing in St. Petersburg, Florida. His income was largely derived from dividends, interest, and revenues from investments in real estate. One of Mr. Fiske's real estate investments was an apartment building in Scranton, Pennsylvania. This building was in the active local management of Sam E. Roskin, an employee of Mr. Fiske for many years. There were 40 apartments, all covered by lease, 3 of them renting for $60.00 monthly, 24 for $75.00, 10 for $85.00, and 3 for $100.00, respectively. Rents were payable monthly in advance on the first of each month.

Mr. Roskin was originally supplied with a cash working fund of $500.00. He was to collect all rents and pay all proper bills. After deducting expenses, his monthly salary of $200.00 and 5% commission on rental collections, Mr. Roskin was to remit the remainder of collections to Mr. Fiske. The remittances for each month were to be made on the twenty-fifth of each month. All cancelled checks and paid invoices were required to be included with the monthly remittance report.

During the past calendar year Mr. Fiske, for several reasons, began to suspect that Mr. Roskin was not remitting correctly. In January of this year you are asked to examine the records of Mr. Roskin and to report as to whether or not a shortage of cash existed as of December 31, 19— and, if so, how much.

The following information is gathered during the course of your audit:

Summary of Roskin's Remittance Reports

| *Last Year* | *Collections* | *Salary* | *Commissions* | *Coal* | *Other Expenses* | *Remittance* |
|---|---|---|---|---|---|---|
| January | $3,100.00 | $200.00 | $155.00 | $1,201.00 | $444.00 | $1,100.00 |
| February | 3,100.00 | 200.00 | 155.00 | 1,076.00 | 517.00 | 1,152.00 |
| March | 2,500.00 | 200.00 | 125.00 | 1,210.00 | 367.00 | 598.00 |
| April | 3,200.00 | 200.00 | 160.00 | 1,207.00 | 727.00 | 906.00 |
| May | 3,100.00 | 200.00 | 155.00 | 1,026.00 | 514.00 | 1,205.00 |
| June | 2,900.00 | 200.00 | 155.00 | 809.00 | 578.00 | 1,058.00 |
| July | 2,900.00 | 200.00 | 145.00 | 109.00 | 383.00 | 2,053.00 |
| August | 2,800.00 | 200.00 | 150.00 | 350.00 | 513.00 | 1,587.00 |
| September | 3,200.00 | 200.00 | 165.00 | 747.00 | 356.00 | 1,723.00 |
| October | 2,800.00 | 200.00 | 150.00 | 246.00 | 254.00 | 1,805.00 |
| November | 2,600.00 | 200.00 | 140.00 | 327.00 | 381.00 | 1,552.00 |
| December | 2,400.00 | 200.00 | 155.00 | 661.00 | 366.00 | 1,018.00 |

The following statement of coal sales and payments was procured from the Daly Coal Company:

SUMMARY OF STATEMENT RECEIVED FROM DALY COAL COMPANY

| | *Charges* | *Credits* | *Balance* |
|---|---|---|---|
| January | $1,201.00 | | $1,201.00 |
| February | 1,076.00 | $1,201.00 | 1,076.00 |
| March | 1,210.00 | 1,076.00 | 1,210.00 |
| April | 1,207.00 | 1,210.00 | 1,207.00 |
| May | 1,026.00 | 1,207.00 | 1,026.00 |
| June | 709.00 | 1,026.00 | 709.00 |
| July | 209.00 | 159.00 | 759.00 |
| August | 350.00 | 250.00 | 859.00 |
| September | 147.00 | 200.00 | 806.00 |
| October | 246.00 | 100.00 | 952.00 |
| November | 327.00 | 168.00 | 1,011.00 |
| December | 561.00 | | 1,572.00 |

The balance in the bank on December 31, 19— was $11.79. There were no known outstanding checks. There was no cash in the office of Mr. Roskin. The uncollected rents amounted to $310.00, representing 3 apartments at $75.00, and one apartment at $85.00. On your re-examination of Roskin's report for September, it appears that the figure of "1" on the invoice for coal had been very carefully altered to a "7".

**Required:**

(4) Prepare a letter reporting your findings to Mr. Fiske.

(2) What would you actually *do* in investigating the accounts of Mr. Roskin?

## The Vacuex Cleaner Corporation

The Vacuex Cleaner Corporation was the manufacturer and distributor of a cylindrical suction cleaner designed for use in the home. For the first nine months of the current calendar year, the condensed profit and loss statement of the company was:

| | | | |
|---|---|---|---|
| Sales, 34,000 at $45.00 | | | $1,530,000.00 |
| Cost of Sales: | | | |
| Materials | | $323,000.00 | |
| Direct Labor | | 408,000.00 | |
| Manufacturing Expenses: | | | |
| Fixed | $136,000.00 | | |
| Variable | 102,000.00 | 238,000.00 | 969,000.00 |
| Gross Profit | | | $ 561,000.00 |
| Selling Expenses: | | | |
| Fixed | | $122,400.00 | |
| Variable | | 221,000.00 | |
| | | $343,400.00 | |
| General Expenses: | | | |
| Fixed | $ 93,500.00 | | |
| Variable | 37,400.00 | 130,900.00 | 474,300.00 |
| Net Profit | | | $ 86,700.00 |

Over the next three months, which includes the Christmas shopping season, the sales manager of the Vacuex Cleaner Corporation wished to sell enough cleaners to establish a new high record for any corporate year in terms of units sold. According to present plans of the company, about 16,000 units might be expected to be sold during October, November, and December at the regular price of $45.00. The sales manager, however, believed that 26,000 units might be sold if the price were reduced to $40.00 per unit for the final three months of the year.

The budget for the year, on the basis of a volume of 50,000 units, showed the following fixed expenses: manufacturing expenses, $200,000.00; selling expenses, $180,000.00; general expenses, $137,500.00.

As auditor, you are asked by the company's president to give your opinion of the profitability of the proposed program.

**Required:**

(1) Should the recommendations of the sales manager be adopted? Prove by setting up two profit and loss statements for the year, one under normal conditions, the other to reflect the proposal of the sales manager.

(2) As a professional accountant, would it be proper for you to give an opinion of this kind? In writing? Discuss.

(3) Would you allow either of the profit and loss statements (in requirement #1) to be used by your client as a basis for a bank loan? Discuss.

## Imperial Grocery Company

The Imperial Grocery Company was located in a middle western city of 500,000 population. The company was organized in 1925, starting with one retail store. On December 31, 1954, it was operating 27 stores, all in the same city. The company was owned by 86 preferred stockholders and 764 common stockholders. About 90% of the stockholders were local residents. Dividends on the 7% cumulative preferred stock had been paid somewhat irregularly—dividend disbursements over the past five years having been: $6.00 in 1954, $4.00 in 1953, $2.00 in 1952, $7.00 in 1951, $7.00 in 1950. On December 31, 1954, dividend arrearages amounted to $9.00 per share. The only dividends paid on the common stock were $2.00 per share in 1939 and $1.00 per share in 1947.

The company's audited, condensed balance sheets for December 31 of the years indicated were:

| *Assets* | *1954* | *1953* | *1952* | *1951* |
|---|---|---|---|---|
| Cash | $ 1,300,000.00 | $ 1,050,000.00 | $ 700,000.00 | $ 600,000.00 |
| Accounts Receivable | 800,000.00 | 650,000.00 | 600,000.00 | 500,000.00 |
| Inventories | 1,600,000.00 | 1,100,000.00 | 1,000,000.00 | 900,000.00 |
| Investment in Imperial Frozen Foods, Inc. | 2,500,000.00 | 2,500,000.00 | 2,500,000.00 | 2,500,000.00 |
| Advances to Imperial Frozen Foods, Inc. | 1,500,000.00 | 1,000,000.00 | 500,000.00 | 500,000.00 |
| Plant and Equipment | 5,500,000.00 | 5,600,000.00 | 5,500,000.00 | 5,400,000.00 |
| Reserve for Depreciation | (3,900,000.00) | (3,750,000.00) | (3,400,000.00) | (3,000,000.00) |
| Goodwill | 2,000,000.00 | 2,500,000.00 | 3,000,000.00 | 3,500,000.00 |
| | $11,300,000.00 | $10,650,000.00 | $10,400,000.00 | $10,900,000.00 |

| *Equities* | | | | |
|---|---|---|---|---|
| Accounts Payable | $ 950,000.00 | $ 1,100,000.00 | $ 800,000.00 | $ 700,000.00 |
| 5½% Notes Payable to Banks | 300,000.00 | 750,000.00 | 600,000.00 | 1,000,000.00 |
| Taxes Payable | 450,000.00 | 200,000.00 | 200,000.00 | 100,000.00 |
| 7% Preferred Stock, $100.00 par | 1,000,000.00 | 1,000,000.00 | 1,000,000.00 | 1,000,000.00 |
| Common Stock, $100.00 par | 5,000,000.00 | 5,000,000.00 | 5,000,000.00 | 5,000,000.00 |
| Earned Surplus | 3,600,000.00 | 2,600,000.00 | 2,800,000.00 | 3,100,000.00 |
| | $11,300,000.00 | $10,650,000.00 | $10,400,000.00 | $10,900,000.00 |

Annual earnings are indicated by analyses of the changes in surplus from year to year. On December 31, 1950, surplus was $3,000,000.00, and goodwill, $3,500,000.00.

The investment in Imperial Frozen Foods, Inc., represented an 84% ownership of common stock. As far as it could be currently appraised, Imperial Frozen Foods, Inc., had passed its early days of "experimentation, development and research" and future capital outlays were expected to be of modest proportion. In its market area, Imperial Frozen Foods, Inc.,

competed with Bird's-Eye, Stokeley's, and other well-known brands. The earned deficit of Imperial Frozen Foods, Inc., on December 31, 1954, was $812,000.00.

It was expected that bank loans would be reduced at least $25,000.00 monthly in 1955.

The question of dividends came before directors at their meeting of March 2, 1955. As auditor of the company you were invited to attend this meeting and to give directors the benefit of your recommendations.

**Required:**

What recommendations would you make and why? Is it proper for an auditor to "sit in" on the formulation of this kind of company policy?

# John F. Coleman

Mr. John F. Coleman operating as the John F. Coleman Company, was engaged in the business of printing, lithographing, stationery, and office supplies. Mr. Coleman had organized his business about 20 years ago and, from a very modest beginning, had developed it to the point where it was the second largest enterprise of its kind in Union City. The net worth of the company on December 31 of the past calendar year was $542,417.00. Assets were $1,011,374.00 and liabilities, $468,957.00. Sales for the year just closed were $784,117.00. Net income, before deduction of managerial salaries, was $118,120.00.

Mr. Coleman was sixty-five years of age, his wife, fifty-eight years. All of his six children were married. Two of his sons acted as assistant managers of the John F. Coleman Company; the third son was professionally interested in dramatics; the three daughters were housewives. Annual managerial salaries for the John F. Coleman Company were: John F. Coleman, $35,000.00, each son, $15,000.00. Mr. Coleman used about $10,000.00 of his salary for gifts to the other four children.

Mr. Coleman was currently considering the advisability of changing the form of his business from a single proprietorship to either a partnership or a corporation. Under each of these business forms, Mr. Coleman would retain substantially his present investment and share of profits. It was also expected that substantially all net income would be disbursed.

In the year in which this question was being considered, various income taxes—in so far as they applied to Mr. Coleman (who reported on the cash basis of accounting)—were:

### Federal Income Taxes

*Personal Income Taxes.* These were calculated as shown below. (Lines are numbered to correspond with Tax Computation Schedule of Form 1040.)

| | |
|---|---|
| 1. Adjusted gross income | $ |
| 2. *Less* Standard deduction | 1,000.00 |
| 3. Net income | $ |
| 4. *Less* $600.00 for each exemption | 1,200.00 |
| 5. | $ |
| 9. One-half of line 5 | $ |
| 10. Tentative tax (from tentative tax schedule) | |
| 11. *Less* $68.00 + 12% of excess of line 10 over $400.00 | |
| 12. | $ |
| 13. Multiply amount on line 12 by 2. This is combined normal tax and surtax | |

The tentative tax schedule, referred to in line #10, is:

| *If the amount on line 9 is:* | *Enter on line 10:* |
|---|---|
| Not over $2,000 | 20% of the amount on line 9. |
| Over $ 2,000 but not over $ 4,000 | $ 400, plus 22% of excess over $ 2,000. |
| Over $ 4,000 but not over $ 6,000 | $ 840, plus 26% of excess over $ 4,000. |
| Over $ 6,000 but not over $ 8,000 | $ 1,360, plus 30% of excess over $ 6,000. |
| Over $ 8,000 but not over $ 10,000 | $ 1,960, plus 34% of excess over $ 8,000. |
| Over $10,000 but not over $ 12,000 | $ 2,640, plus 38% of excess over $10,000. |
| Over $12,000 but not over $ 14,000 | $ 3,400, plus 43% of excess over $12,000. |
| Over $14,000 but not over $ 16,000 | $ 4,260, plus 47% of excess over $14,000. |
| Over $16,000 but not over $ 18,000 | $ 5,200, plus 50% of excess over $16,000. |
| Over $18,000 but not over $ 20,000 | $ 6,200, plus 53% of excess over $18,000. |
| Over $20,000 but not over $ 22,000 | $ 7,260, plus 56% of excess over $20,000. |
| Over $22,000 but not over $ 26,000 | $ 8,380, plus 59% of excess over $22,000. |
| Over $26,000 but not over $ 32,000 | $10,740, plus 62% of excess over $26,000. |
| Over $32,000 but not over $ 38,000 | $14,460, plus 65% of excess over $32,000. |
| Over $38,000 but not over $ 44,000 | $18,360, plus 69% of excess over $38,000. |
| Over $44,000 but not over $ 50,000 | $22,500, plus 72% of excess over $44,000. |
| Over $50,000 but not over $ 60,000 | $26,820, plus 75% of excess over $50,000. |
| Over $60,000 but not over $ 70,000 | $34,320, plus 78% of excess over $60,000. |
| Over $70,000 but not over $ 80,000 | $42,120, plus 81% of excess over $70,000. |
| Over $80,000 but not over $ 90,000 | $50,220, plus 84% of excess over $80,000. |
| Over $90,000 but not over $100,000 | $58,620, plus 87% of excess over $90,000. |

*Corporation Taxes.* The normal tax rates on corporate net income were:

| *Net Income* | |
|---|---|
| Up to $5,000 | 15%. |
| $ 5,000 up to 20,000 | $ 750, plus 17% of excess over $ 5,000. |
| 20,000 up to 25,000 | 3,300, plus 19% of excess over 20,000. |
| 25,000 up to 50,000 | 4,250, plus 31% of excess over 25,000. |
| Over 50,000 | 24% of entire amount. |

The surtax rates were:

| | |
|---|---|
| Up to $25,000 | 6%. |
| $25,000 up to 50,000 | $1,500, plus 22% of excess over $25,000. |
| Over 50,000 | 14% of entire amount. |

In the calculation of corporate income taxes, there was no income exempt from tax.

### State Income Taxes

On individuals, the tax was 2% on the first $1,000 of taxable income, 3% on the 2nd and 3rd $1,000, 4% on the 4th and 5th $1,000, 5% on the 6th and 7th $1,000, 6% on the 8th and 9th $1,000, and 7% on remaining income. On personal returns there was $2,500 of exempt income for married couples

and $400 for each additional claimed exemption. The tax on corporations was a flat rate of 5%. There was no exempt income for corporations.

NOTE.—Under accrual accounting the corporation state income tax for the current year was deductible in calculating federal income taxes and, likewise, the federal income tax for the current year was deductible in calculating state income taxes. Under cash accounting, the taxes deductible were those actually paid during the year.

**Required:**

(1) In attempting to solve his problem, Mr. Coleman turns to you, as company auditor, for advice. What kind of business organization would you recommend? Why?

(2) Under which type of business organization (proprietorship or corporation) would Mr. Coleman's aggregate tax bill be the greatest for the past calendar year? Show your calculations. (For the previous calendar year, Mr. Coleman's federal income tax was $30,020.00 and his state income tax, $2,180.00. These taxes were paid on March 15 of the past calendar year.)

## The Bee Company*

Mr. Andrews, who is a client of yours and a stockholder of The Bee Company, although not active in its management, presents you with the comparative statements and other data shown below. He advises that he has been a stockholder of the company for several years and has received $1.00 per share in dividends regularly.

The president of the company, who is getting along in years, has offered to sell him a substantial block of stock at book value and has explained to Mr. Andrews that the loss of this year was due to the general depression.

Your client asks you to make a detailed analysis of the statements and give him your opinion as to whether or not it would be a good investment; and, further, to adivse him in detail of whatever may be reasonably interpreted from the statements as to the company's financial condition, efficiency, management policies, and prospects, together with suggestions as to what should be watched or corrected, and so on.

### THE BEE COMPANY

COMPARATIVE BALANCE SHEETS, DECEMBER 31

| *Assets* | *This Year* | *Last Year* |
|---|---|---|
| Cash | $ 40,000.00 | $ 15,000.00 |
| Notes Receivable (customers' coal stoves and ranges) | 17,500.00 | 2,000.00 |
| Accounts Receivable: | | |
| Gas Stoves and Ranges | 65,000.00 | 45,000.00 |
| Coal Stoves and Ranges | 140,000.00 | 115,000.00 |
| Inventories: | | |
| Gas Stoves and Ranges | 110,000.00 | 145,000.00 |
| Coal Stoves and Ranges | 275,000.00 | 225,000.00 |
| | $ 647,500.00 | $547,000.00 |
| Real Estate, Machinery and Equipment, *less* Allowance for Depreciation | 375,000.00 | 325,000.00 |
| Salesmen's Drawing Accounts | 15,000.00 | |
| Deferred Expenses | 5,000.00 | 2,000.00 |
| | $1,042,500.00 | $874,000.00 |
| *Equities* | | |
| Accounts Payable | 75,000.00 | $ 50,000.00 |
| Notes Payable to Bank (secured) | 5,000.00 | |
| Notes Payable to Bank (unsecured) | 300,000.00 | 100,000.00 |
| | $ 380,000.00 | $150,000.00 |
| Capital Stock, $10.00 par | 450,000.00 | 450,000.00 |
| Surplus | 212,500.00 | 274,000.00 |
| | $1,042,500.00 | $874,000.00 |
| Appraised sound values are | | |
| Land | $ 50,000.00 | $ 50,000.00 |
| Foundations | 10,000.00 | 10,000.00 |
| Buildings, machinery and equipment | 400,000.00 | 340,000.00 |

## THE BEE COMPANY

STATEMENT OF INCOME AND EXPENSE

| | *This Year* | *Last Year* | *Previous Year* | *Next Previous Year* |
|---|---|---|---|---|
| Net Sales: | | | | |
| Coal Stoves and Ranges... | $ 675,000.00 | $ 825,000.00 | $ 900,000.00 | $ 925,000.00 |
| Gas Stoves and Ranges... | 725,000.00 | 600,000.00 | 500,000.00 | 400,000.00 |
| | $1,400,000.00 | $1,425,000.00 | $1,400,000.00 | $1,325,000.00 |
| Cost of Sales.............. | 1,026,500.00 | 1,025,000.00 | 960,000.00 | 875,000.00 |
| Gross Profit............... | $ 373,500.00 | $ 400,000.00 | $ 440,000.00 | $ 450,000.00 |
| Salesmen's Commissions, Salaries, and Expenses: | | | | |
| Coal Stoves and Ranges. | $ 75,000.00 | $ 85,000.00 | $ 90,000.00 | $ 92,000.00 |
| Gas Stoves and Ranges. | 70,000.00 | 50,000.00 | 37,500.00 | 30,000.00 |
| President's Salary.......... | 20,000.00 | 20,000.00 | 20,000.00 | 20,000.00 |
| Other Expenses, including Income Taxes............. | 225,000.00 | 225,000.00 | 225,000.00 | 225,000.00 |
| | $ 390,000.00 | $ 380,000.00 | $ 372,500.00 | $ 367,000.00 |
| Net Profit................. | $ (16,500.00) | $ 20,000.00 | $ 67,500.00 | $ 83,000.00 |

Gas stoves and ranges were sold exclusively to a utility company and to a mail-order house.

The company carried blanket insurance coverage on buildings and contents in the face value of $500,000.00 with a 90% coinsurance clause.

**Required:**

List and discuss the principal points that you would include in a letter to your client.

## Hall Instrument Company*

The Hall Instrument Company was organized January 1, 1956, to manufacture precision instruments and has been successful from the outset. The company has developed a number of minor patents which do not appear on the books as assets. However, there are no basic patents and no important secret processes. The record to date appears to be due largely to good production management, lack of severe domestic competition, success in importing skilled labor, and effective selling effort. In 1960, competition was becoming more active and profits were somewhat curtailed as a result. Mr. J. B. Hall (president and general manager) died late in 1960, and his services will be missed with respect to selling as well as production. Notwithstanding these adverse factors the prospects of the enterprise for the next three or four years appear to be good. If control is purchased by the Bowen-Cross Company, it is expected that an aggressive and capable management will be in charge. On December 31, 1960, unfilled orders of the company were at the highest point in over two years.

The Bowen-Cross Company is considering the purchase as of December 31, 1960, of 4,000 shares of the common stock of the Hall Instrument Company held by the estate of J. B. Hall.

Acting on behalf of the prospective buyer, the following balance sheet, summary of income and expense, and other special data were compiled by you from the audit reports (of other accounts) and other sources.

(1) Condensed balance sheet, December 31, 1960:

| *Assets* | | *Equities* | |
|---|---|---|---|
| Cash | $ 30,000.00 | Accounts Payable | $ 25,000.00 |
| Accounts Receivable | 25,000.00 | Accrued Liabilities | 15,000.00 |
| Insurance on J. B. Hall | 50,000.00 | 6% Mortgage Payable | 45,000.00 |
| Inventories | 40,000.00 | Capital Stock, $100.00 par | 50,000.00 |
| Building and Equipment (net) | 60,000.00 | Surplus | 100,000.00 |
| Land | 30,000.00 | | |
| | $235,000.00 | | $235,000.00 |

(2) Income, and earned surplus data:

| *Year* | *Sales* | *Expenses, Interest and Taxes* | *Net Profit* | *Dividends* | *Surplus* |
|---|---|---|---|---|---|
| 1956 | $ 60,000.00 | $55,000.00 | $ 5,000.00 | $ 1,500.00* | $ 3,500.00 |
| 1957 | 90,000.00 | 65,000.00 | 25,000.00 | 1,500.00* | 27,000.00 |
| 1958 | 100,000.00 | 70,000.00 | 30,000.00 | 25,000.00 | 32,000.00 |
| 1959 | 118,000.00 | 80,000.00 | 38,000.00 | 25,000.00 | 45,000.00 |
| 1960 | 105,000.00 | 75,000.00 | 80,000.00 | 25,000.00 | 100,000.00 |

* Preferred dividends.

(3) At its date of organization the company issued 250 shares of 6% preferred stock, $100.00 par. This stock was redeemed on December 31, 1958, at the redemption price of $105.00 per share, the premium being charged to general expense.

(4) The company is the beneficiary of an insurance policy on the life of J. B. Hall in the amount of $50,000.00. It is expected that the face value of the policy will be collected early in 1961, and the present plan is to use a part of the proceeds to pay the balance of the mortgage. The original amount borrowed (on January 1, 1956) was $60,000.00, and 5% of this principal has been paid each year.

(5) Organization costs, commissions, etc., totaling $7,600.00 were written off at the end of 1958. These costs were all bona fide charges incurred in launching the company.

(6) Accrued depreciation on the books is $15,000.00. To be wholly adequate, the reserve should be increased by $10,000.00. The facilities are of modern type and there is no marked divergence between original cost and replacement cost.

(7) Mr. Hall's annual salary was only $5,000.00. A more reasonable figure for the type of service rendered is $12,000.00 per year.

(8) The amount of the allowance for bad debts is satisfactory and the inventories are priced properly.

(9) The fair market value of the company's land, determined by competent realtors, exceeds the cost (and book value) by at least $20,000.00.

In addition the following determinations and estimates are made with respect to the position and prospects of the Hall Instrument Company:

(10) The gross volume of business for the next three or four years is expected to average around $110,000.00.

(11) Land and building facilities are adequate but to maintain its position the company should spend around $25,000.00 in the near future for new equipment. The investment in new equipment, if made, will increase depreciation charges about $5,000.00 annually.

(12) Aside from points noted above, the company's operating expenses are expected to average $5,000.00 per year in excess of their average for the past three years.

(13) Federal income taxes are expected to average $7,500.00 per year in excess of the level of these taxes of the past three years.

(14) If the Bowen-Cross Company acquires control, it is expected to raise the money for the additional equipment required through the issue of capital stock. Working capital requirements for the future are assumed to be taken care of by existing resources, including the balance of cash from life insurance proceeds. The amount of current liabilities on December 31, 1960, is a fair estimate of average liabilities for the future.

(15) It is unsafe to assume that the rate of profits to be earned after the next four years (1961–1964) will exceed an ordinary rate of return on business investments of this general character. Directors of the Bowen-Cross Company feel that the commitment should not be made unless a net return of at least 6% on the investment (with adequate protection for principal) seems to be reasonably assured.

**Required:**

Prepare an estimate of the fair market value per share of the stock of the Hall Instrument Company. Support your estimate with a schedule or schedules showing full explanations and computations

# 16. FINANCIAL STATEMENTS

## Auditor's Certificates

Following are the audit certificates of three well-known accounting firms:

To the Stockholders and Board of Directors of
Sears, Roebuck and Co.:

We have examined the consolidated balance sheet of Sears, Roebuck and Co. and consolidated subsidiary companies as of January 31, 1949, and the related statement of consolidated income and surplus for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the companies and, without making a detailed audit of transactions, have examined or tested accounting records of the companies and other supporting evidence, by methods, and to the extent we deemed appropriate. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures we considered necessary.

In our opinion the accompanying consolidated balance sheet and related statement of consolidated income and surplus present fairly the financial position of Sears, Roebuck and Co. and consolidated subsidiaries at January 31, 1949, and the results of their operations for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

TOUCHE, NIVEN, BAILEY & SMART

Chicago, Illinois
March 18, 1949.

To the Stockholders,
Remington Rand, Inc.

We have examined the consolidated balance sheet of Remington Rand Inc., and its consolidated subsidiaries as of March 31, 1949 and the consolidated statements of profit and loss and surplus for the fiscal year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We tested accounts and drafts receivable and trade accounts payable by communication with the individual debtors and creditors. Our representatives were present at the manufacturing plants and at certain of the larger sales offices of the companies during periods of inventory taking, observed methods employed in determining quantities and made tests of such quantities. We also reviewed the basis of inventory pricing.

In our opinion, the accompanying balance sheet and statements of income and surplus present fairly the financial position of Remington Rand Inc. and its con-

solidated subsidiaries at March 31, 1949 and the results of their operations for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST

June 1, 1949.

To the Stockholders of
United States Steel Corporation:

As independent auditors elected at the annual meeting of stockholders of United States Steel Corporation held on May 3, 1948, we have examined the consolidated statement of financial position of United States Steel Corporation and subsidiaries as at December 31, 1948, and the consolidated statement of income for the year 1948. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

During the year 1948 the Corporation adopted a policy, which we approve, of accelerating depreciation on the cost of new facilities retroactive to January 1, 1947. Under this policy the accelerated depreciation for the year 1947 is $28,975,094 or $2,675,094 more than the amount reported for the year as depreciation added to cover replacement cost. The amount of $55,335,444 provided for accelerated depreciation in 1948 includes this adjustment of $2,675,094. In all other respects the accounting principles were applied during the year on a basis consistent with that of the preceding year.

In our opinion, the accompanying consolidated statement of financial position and related statement of income, together with the notes thereto, present fairly the position of United States Steel Corporation and its subsidiaries at December 31, 1948, and the results of the year's operations in conformity with generally accepted accounting principles.

PRICE, WATERHOUSE & CO.

New York, February 23, 1949.

**Required:**

(1) What are the basic requirements of an auditor's certificate?
(2) Examine the above three certificates and criticize them intelligently.

## Allen & Benson

The condensed trial balance of the partnership of Allen & Benson on December 31, 19— was:

| | | |
|---|---|---|
| Cash and Sundry Assets | $390,000.00 | |
| Accounts Payable | | $200,000.00 |
| Allen, E. S., Capital | | 60,000.00 |
| Benson, J. T., Capital | | 40,000.00 |
| Benson, J. T., Notes Payable | | 100,000.00 |
| Sales | | 320,000.00 |
| Cost of Sales | 200,000.00 | |
| Operating Expenses (paid) | 130,000.00 | |
| | $720,000.00 | $720,000.00 |

You find that the accounts payable were all paid on December 31, 19—, less cash discounts of 5%. These checks have not yet been recorded. You also find that one year's interest at 10% annually has accrued on the note payable, dated January 1 of the current year.

On December 31, 19— (one year ago), the balance sheet of the partnership showed E. S. Allen, Capital, $60,000.00; J. T. Benson, Capital, $40,000.00.

**Required:**

Detailed profit and loss statement for the current year.

## The Standard Supply Company

The Standard Supply Company was a partnership comprised of L. A. Halley, G. S. Penney, A. G. Raymond, and R. T. Symington. The partners decided that their respective interests would be served better if the partnership were converted into a corporation of the same business name. The following information presents the real accounts of the partnership at (1) balances found on the books, and (2) fair values for the transfer of these accounts to the corporation:

| *Assets* | | *Balance Sheet Values* | *Fair Market Values* |
|---|---|---|---|
| Cash | | $378,115.00 | $378,115.00 |
| Marketable Securities | | 80,400.00 | 73,700.00 |
| Accounts Receivable | | 605,790.00 | 605,790.00 |
| Reserve for Bad Debts | | (111,625.00) | (200,000.00) |
| Inventories | | 860,080.00 | 924,245.00 |
| Prepaid Expenses | | 106,075.00 | 106,075.00 |
| Machinery, Fixtures, Equipment | | 601,055.00 | 375,000.00 |
| Buildings | | 974,835.00 | 875,000.00 |
| Land | | 125,000.00 | 250,000.00 |
| | | $3,619,725.00 | |
| *Equities* | | | |
| Notes Payable | | $400,000.00 | $400,000.00 |
| Accounts Payable | | 305,050.00 | $305,050.00 |
| | *P & L Ratios* | | |
| L. A. Halley | 25% | 645,080.00 | |
| G. S. Penney | 20% | 568,600.00 | |
| A. G. Raymond | 25% | 719,020.00 | |
| R. T. Symington | 30% | 981,975.00 | |
| | | $3,619,725.00 | |

The Standard Supply Company, accordingly, was organized as a corporation with an authorized capitalization of $1,000,000.00 cumulative convertible 6% preferred stock, and $3,000,000.00 common stock, all stock to be voting stock and of $100.00 par value.

Preliminary to the actual transfer of the assets and liabilities to the corporation, and issuance of stock certificates, partners' capital accounts were to be rounded off to the nearest even hundreds of dollars. To accomplish this, the individual partners were to pay in or receive cash in the proper amounts.

The assets and liabilities of the partnership were taken over by the corporation at their fair market values. In exchange for the net assets acquired, the corporation issued $200,000.00 of preferred stock to each of the four

partners and common stock to complete the settlements. The balance of the unissued preferred stock was sold to the four partners at a price of $100.00 per share. Of this amount one-fourth of the purchase price was immediately received in cash; the balance was payable in three equal annual installments, the first of these installments to be payable one year from date.

Shortly after the corporation commenced operations, the four stockholders (the old partners) discovered that they had failed to place any part of the net worth of the partnership in the Surplus account of the corporation and that, because of this failure, directors of the corporation were precluded from declaring dividends on the preferred and common stocks of the company. To overcome this current difficulty, the four common stockholders decided to donate 20% of their common stock to the corporation for the specified purpose of creating a surplus out of which dividends might be paid immediately. (In the state in which the Standard Supply Company was located, this action was legal.) The amount of the donation, roughly, was equal to the undisbursed earnings of the partnership.

The donation was made as agreed, whereupon, directors declared an initial quarterly cash dividend on the preferred stock and a cash dividend of 2% on the common stock.

**Required:**

Prepare a balance sheet giving effect to the foregoing transactions. The books of the partnership were converted to the use of the corporation.

## Martin & Company, Inc.

Following is the trial balance of Martin & Co., Inc., on December 31, 1954:

| | | |
|---|---|---|
| Cash | $ 621,000.00 | |
| Notes Receivable | 180,000.00 | |
| Accounts Receivable | 920,000.00 | |
| Inventories | 500,000.00 | |
| Accounts Receivable—Martin Sales Co. | 27,000.00 | |
| Investment in Martin Sales Company, 10,000 shares common stock of $100.00 par value | 600,000.00 | |
| Land | 6,000.00 | |
| Building | 60,000.00 | |
| Machinery and Equipment | 270,000.00 | |
| Office Equipment | 40,000.00 | |
| Reserve for Depreciation | | $ 145,000.00 |
| Accounts Payable | | 236,000.00 |
| Common Stock, $100.00 par | | 2,000,000.00 |
| Surplus | | 1,119,000.00 |
| Sales | | 7,000,000.00 |
| Purchases | 3,708,000.00 | |
| Direct Labor | 1,000,000.00 | |
| Manufacturing Expenses | 530,000.00 | |
| Selling Expenses | 1,320,000.00 | |
| General Expenses | 718,000.00 | |
| | $10,500,000.00 | $10,500,000.00 |

On investigation the following further information is disclosed:

(1) Checks totaling $10,000.00 in settlement of accounts payable were entered in the cash book under date of December 31, 1954; they were not mailed, however, until January 20, 1955.

(2) Accounts receivable include an amount of $200,000.00 representing capital advances made to the Martin Sales Company during 1954.

(3) It is estimated that 10% of the ordinary trade accounts and notes receivable are of doubtful collectibility.

(4) The inventory at December 31, 1954, consists of:

| | |
|---|---|
| Inventory on hand | $538,000.00 |
| Merchandise in transit for which the liability has not been recorded | 12,000.00 |
| | $550,000.00 |

(5) Depreciation expense for the year has not been recorded. Annual depreciation rates are as follows: buildings, 5%; machinery and equipment, 10%; and office equipment, 10%. During 1954 no changes occurred in the balances of fixed asset accounts.

(6) No adjustments were ever made covering insurance premiums, all of which when paid were charged to general expense:

| | |
|---|---|
| Prepaid at December 31, 1953 | $3,000.00 |
| Prepaid at December 31, 1954 | 2,000.00 |

(7) No adjustments were ever made covering property taxes, all of which when paid were charged to general expense:

| | |
|---|---|
| Prepaid at December 31, 1953 | $6,000.00 |
| Prepaid at December 31, 1954 | 9,000.00 |

(8) No adjustments were ever made covering commissions, all of which when paid were charged to selling expense:

| | |
|---|---|
| Accrued at December 31, 1953 | $4,000.00 |
| Accrued at December 31, 1954 | 6,000.00 |

(9) Cash dividends were declared on December 31, 1954, as follows: by Martin & Company, Inc. 6% to stock of record January 10, 1955; and by Martin Sales Company, 5% to stock of record January 15, 1955.

**Required:**

(1) Profit and loss statement for 1954. Use the "all-inclusive" style of income statement.

(2) Balance sheet as of December 31, 1954. Items should be classified properly.

## Duke Manufacturing Company

On January 1, 19—, the Duke Manufacturing Company estimated its manufacturing costs of the next twelve months on the following information:

| | |
|---|---|
| Materials | $2,400,000.00 |
| Direct Labor | 1,920,000.00 |
| Rent: Factory | 30,000.00 |
| General Office | 10,000.00 |
| Depreciation Expense: Factory | 85,000.00 |
| General Office | 15,000.00 |
| Heat, Light, Power: Factory | 61,000.00 |
| General Office | 15,000.00 |
| Indirect Wages and Salaries: Factory | 541,000.00 |
| General Office | 480,000.00 |
| Supplies consumed: Factory | 40,000.00 |
| General Office | 7,000.00 |
| Insurance: Factory | 11,000.00 |
| General Office | 1,000.00 |

The above costs were estimated upon the basis of a production of 1,000 units per month. Manufacturing expenses were distributed to production on a unit or labor cost basis. On June 30, 19—, the year to date showed only a production of 3,600 units, sales of 3,000 units, and manufacturing expenses incurred of $324,000.00 and non-factory expenses of $250,000.00.

Sales were made at prices based on the year's estimated manufacturing costs; and they were expected to yield a net profit of 10%.

**Required:**

(1) Prepare the profit and loss statement for the six months ending June 30, 19—. There were no beginning or ending inventories except for the inventory of finished goods on June 30, 19—.

(2) What adjusting entry, or entries, should be made June 30, 19—?

(3) Based on the year's costs to date, what should be the new selling price?

(4) Are there any factors that would prevent the management from making effective the price established in the preceding requirement?

(5) From the management point of view, why are manufacturing expenses important? Explain carefully.

## The Lewis Packard Company

The Lewis Packard Company was a regional distributor of Packard electric refrigerators, stoves, washing machines, vacuum cleaners, radios, and television sets and maintained its headquarters in Mason City, Georgia. On December 31 (this year), the company's highly condensed balance sheet (in trial balance form) was:

| | | |
|---|---|---|
| Cash | $ 361,000.00 | |
| Accounts Receivable: | | |
| —due in 6 months or less | 172,000.00 | |
| —due in 7–12 months | 86,000.00 | |
| —due in 13–17 months | 47,000.00 | |
| —due in 18 months or more | 29,000.00 | |
| | $ 334,000.00 | |
| Merchandise | | |
| —Not including a sight-draft-bill-of-lading shipment of unordered merchandise to Chamberlain & Co., Inc., a new customer in Eastville, Tennessee. (Sales price, $4,000.00, cost, $3,000.00) | 164,000.00 | |
| Securities | | |
| —Consisting of Packard Manufacturing Company 5% bonds, purchased on January 1 (this year) at 90, interest payable January 1 and July 1, due 10 years from date of purchase; at par | 100,000.00 | |
| Equipment, Machinery, and Trucks | 40,000.00 | |
| Reserve for Depreciation | | $ 39,999.00 |
| —Although fixed assets have been written down to a nominal net book value of $1.00 (by direction of the company's Committee on Accounting and Financial Policy), actually about 45% of their useful life remains. | | |
| Packard Franchise, at cost | 50,000.00 | |
| —Purchased 10 years prior to the date of this balance sheet, said nontransferable franchise being cancellable at any time by either party without financial reimbursement. | | |
| Accounts Payable | | 12,000.00 |
| —After giving effect to checks drawn in the week following the date of this balance sheet, but dated and recorded in the books, December 31, 19—, $38,000.00 | | |
| 6% Notes Payable, dated January 1 (last year), $25,000.00 being payable on each January 1 thereafter | | 100,000.00 |
| 6% Notes Payable, held in Treasury | 25,000.00 | |
| Reserve for Income Taxes Payable of Current Year | | 50,000.00 |
| Reserve for Product Warranties and Guaranties | | 25,000.00 |
| —This account measures the probable costs to be incurred over the next 12 months in "making good" on warranties and guaranties. | | |

| | | |
|---|---|---|
| Reserve for Contingencies | | 75,000.00 |
| Convertible 6% Preferred Stock, $100.00 par | | 300,000.00 |
| —All of this stock was converted into common stock on November 1 of the current year at the rate of 16 shares of common stock for every 5 shares of preferred stock. | | |
| Common Stock, no-par, 14,000 shares | | 350,000.00 |
| —This balance does not give effect to the conversion of the preferred stock. | | |
| Common Stock in Treasury, 1,000 shares, at cost | 30,000.00 | |
| Earned Surplus | | 152,001.00 |
| | $1,104,000.00 | $1,104,000.00 |

**Required:**

(1) Prepare a well organized balance sheet which you would be willing to "certify" as of December 31, 19—.

(2) Prepare the auditor's certificate which should accompany this balance sheet and its related statement of income.

(3) Working papers for the Common Stock account.

## Kraft Manufacturing Company

Following is the after-closing trial balance of The Kraft Manufacturing Company on December 31, 19—:

| | | |
|---|---|---|
| Accounts Payable (credit balances, $373,000.00, debit balances, $25,000.00) | | $ 348,000.00 |
| Accounts Receivable (debit balances, $616,000.00, credit balances, $14,000.00) | $602,000.00 | |
| Accounts Receivable—Officers and Employees (current) | 28,000.00 | |
| Bond Interest Payable | | 30,000.00 |
| Bonds Payable, 6% (of which $100,000.00 are due annually for payment, beginning next year) | | 1,000.000.00 |
| Building, not used in operations, net (after reserve for depreciation, $10,000.00) | 90,000.00 | |
| Capital Surplus | | 512,500.00 |
| Cash | 381,999.00 | |
| Cash Dividend Payable—Preferred Stock | | 5,000.00 |
| Common Stock, authorized 125,000 shares no-par, issued 80,000, unissued 45,000 shares of which 25,000 shares are reserved for employees' stock option plan | | 1,500,000.00 |
| Corporation Bonds, at cost[1] | 72,000.00 | |
| Earned Surplus | | 778,500.00 |
| Experimental and Research Costs | 250,000.00 | |
| Finished Goods, at cost[2] | 364,000.00 | |
| Goodwill | 500,000.00 | |
| Land | 100,000.00 | |
| Land, not used in operations | 10,000.00 | |
| Notes Payable, payable $4,000.00 on the first of each month. All interest is paid to date | | 100,000.00 |
| Notes Receivable | 300,000.00 | |
| Notes Receivable Discounted | | 200,000.00 |
| Organization Expense | 10,000.00 | |
| Patents | 125,000.00 | |
| Plant, Machinery, and Equipment | 1,712,000.00 | |
| Preferred Stock, 4% Cumulative, $100.00 par | | 500,000.00 |
| Prepaid Advertising | 24,000.00 | |
| Prepaid Insurance | 12,000.00 | |
| Raw Materials[3] | 241,000.00 | |
| Reserve for Contingencies | | 100,000.00 |
| Reserve for Depreciation | | 407,000.00 |
| Reserve for Future Research Costs | | 200,000.00 |
| Reserve for Uncollectible Accounts | | 12,000.00 |
| Social Security Taxes Payable | | 9,000.00 |
| Stocks in Subsidiary and Affiliated Companies[4] | 428,000.00 | |
| Stock Dividend Payable[5] | | .......... |

[1] Market value, $60,000.00. These bonds were carried as short term investments.
[2] Market value, $400,000.00.
[3] Market value, $210,000.00.
[4] Market value, $400,000.00.
[5] A stock dividend of 20% was declared by directors to stock of record, December 31, 19—.

| | | |
|---|---|---|
| Sundry Materials and Supplies | 26,000.00 | |
| Trade-marks and Trade-names | 1.00 | |
| Treasury Stock, Common, 10,000 shares at cost | 200,000.00 | |
| Unamortized Bond Discount | 50,000.00 | |
| U.S. Income Taxes Payable | | 25,000.00 |
| U.S. Treasury Savings Notes (to be used for payment of Income Taxes) | 25,000.00 | |
| Work in Process | 176,000.00 | |
| | $5,727,000.00 | $5,727,000.00 |

**Required:**

Balance sheet in good form, including proper classification of items. Prepaid expenses should be classified as current assets. The company was defendant in a suit by the Collector of Internal Revenue, for additional income taxes of $114,000.00 allegedly due for the year 19— (three years ago).

## Truman's Cut-Rate Drug Company

Truman's Cut-Rate Drug Company began operations on January 20, 1954. On December 31, 1954 the bookkeeper's trial balance was:

| | | |
|---|---|---|
| Cash | $ 13,553.44 | |
| Cash Deposit with the Co-operative Wholesale Drug Company | 1,000.00 | |
| Cash Deposits with Utilities | 500.00 | |
| Accounts Receivable | 3,128.32 | |
| Fixtures and Equipment | 78,818.08 | |
| Remodeling Expense | 14,765.60 | |
| Organization Expense | 1,134.40 | |
| Accounts Payable | | $ 29,407.28 |
| Notes Payable | | 40,000.00 |
| Common Stock, $1.00 par | | 80,000.00 |
| Capital Surplus | | 16,000.00 |
| Sales | | 293,320.24 |
| Purchases | 258,648.24 | |
| Purchases Discounts | | 2,315.76 |
| Freight and Express on Purchases | 1,480.96 | |
| Advertising Expense | 17,061.28 | |
| General Expense | 9,181.76 | |
| Interest Expense | 2,858.64 | |
| Rent Expense | 12,000.00 | |
| Salaries and Wages | 33,643.28 | |
| Sales Tax Expense | 5,049.92 | |
| Utilities Expense | 8,219.36 | |
| | $461,043.28 | $461,043.28 |

The following information for adjusting and closing the books is obtained by you from various sources:

(1) The inventory of merchandise on hand, December 31, 1954, is $54,081.92.

(2) Rent is payable monthly in advance, $1,000.00 on the 20th of each month.

(3) During the year various kinds of supplies were purchased and debited to General Expense. On December 31, 1954, the inventory of supplies on hand is $2,400.00.

(4) The cash of $13,553.44 includes $96.00 of worthless checks.

(5) There are unrecorded general expense bills on hand amounting to $255.44.

(6) Depreciation on fixtures and equipment should be computed at the rate of 8% annually.

(7) Remodeling Expense is a deferred charge. The balance of $14,765.60 should be written off at the rate of 10% annually.

(8) An accounts receivable claim against the Valley Drug Company for $919.04 has been compromised for $500.00. On January 10, 1955, a check

for $500.00 was received from the Valley Drug Company in full settlement of their account.

(9) The notes payable consist of one note in favor of the Central National Bank for $24,000.00, dated October 20, 1954, and due January 20, 1955, with running interest at 8%. This interest has not been recorded on the books. The other note payable, $16,000.00, is for funds advanced by the largest stockholder of the company. For the time being, the funds have been advanced without interest cost to the corporation.

(10) Unrecorded and unpaid taxes for 1954 amount to $680.00.

(11) The unrecorded and unpaid utility bills (water, light, gas, etc.) for December, 1954, amount to $706.32.

(12) Organization expense is to be written off at the rate of 20% annually.

(13) During 1954 the sales taxes collected from customers have been included in the credit to Sales. The monthly sales tax remittances to the State Treasurer have been debited to Sales Tax Expense. On December 31, 1954, there was a sales tax of $701.44 due to the State Treasurer for the sales taxes collected on December sales.

(14) The company is liable for social security taxes on its payroll. (For the purpose of this problem the liability for social security taxes may be taken to be 2% of the payroll for old age insurance, and 3% for unemployment insurance.) This unrecorded liability is payable early in 1955.

**Required:**

(1) Profit and loss statement for January 20–December 31, 1954.

(2) Balance sheet, December 31, 1954.

## The Swift Corporation

The Swift Corporation manufactures and sells a durable consumer good of standard design (retailing at approximately $200.00 per unit). It also regularly manufactures a substantial portion of the tools used in its factory. At the beginning of the present calendar year, it was expected that manufacturing costs would follow the pattern of the preceding year when production costs were: raw materials, $1,470,000.00; direct labor, $520,000.00; and manufacturing expense, $650,000.00.

An examination of the Stores Register shows raw materials disbursed during the present calendar year as follows: for direct use in manufacturing operations, $1,500,000.00; for indirect use in manufacturing operations, $50,000.00; and for the manufacture of tools, $5,000.00. Of the direct labor costs of the current year, $20,000.00 was direct labor expended in the manufacture of tools. There were no tools-in-process at the end of the year. Manufacturing expenses were applied at the rate of 100% of direct labor costs. (Depreciation expense on tools manufactured during the current year may be disregarded.)

On January 1, 19— the inventory valuations were:

| | *Raw Materials* | *Work in Process* | *Finished Goods* | *Total* |
|---|---|---|---|---|
| Raw materials, at cost... | $305,000.00 | $170,000.00 | $ 50,000.00 | $525,000.00 |
| Direct labor............ | | 125,000.00 | 80,000.00 | 205,000.00 |
| Manufacturing expense.. | | 125,000.00 | 80,000.00 | 205,000.00 |
| | $305,000.00 | $420,000.00 | $210,000.00 | $935,000.00 |

Valuations for the new inventories of December 31, 19— were detailed as follows:

| | *Raw Materials* | *Work in Process* | *Finished Goods* | *Total* |
|---|---|---|---|---|
| Raw materials, at cost.. | $350,000.00 | $ 80,000.00 | $150,000.00 | $ 580,000.00 |
| Direct labor.......... | | 110,000.00 | 200,000.00 | 310,000.00 |
| Manufacturing expense | | 110,000.00 | 200,000.00 | 310,000.00 |
| | $350,000.00 | $300,000.00 | $550,000.00 | $1,200,000.00 |

The condensed trial balance of the company on December 31, 19— was:

| | | |
|---|---|---|
| Cash.................................... | $1,190,000.00 | |
| Accounts Receivable.................... | 300,000.00 | |
| Finished Goods......................... | 550,000.00 | |
| Work in Process........................ | | $ 180,000.00 |
| Raw Materials.......................... | | 1,250,000.00 |
| Buildings.............................. | 280,000.00 | |
| Reserve for Depreciation—Buildings...... | | 50,000.00 |

| | | |
|---|---|---|
| Machinery | 660,000.00 | |
| Reserve for Depreciation—Machinery | | 270,000.00 |
| Tools | 50,000.00 | |
| Reserve for Depreciation—Tools | | 25,000.00 |
| Tools in Process | 25,000.00 | |
| Land | 30,000.00 | |
| Vouchers Payable | | 450,000.00 |
| Common Stock, $100.00 par | | 1,000,000.00 |
| Earned Surplus | | 2,000,000.00 |
| Sales | | 3,000,000.00 |
| Cost of Sales | 2,240,000.00 | |
| Purchases of Raw Materials | 1,600,000.00 | |
| Direct Labor | 500,000.00 | |
| Manufacturing Expense Applied | | 500,000.00 |
| Depreciation Expense—Building | 7,000.00 | |
| Depreciation Expense—Machinery | 66,000,00 | |
| Depreciation Expense—Tools | 12,000.00 | |
| Heat, Light, Power | 40,000.00 | |
| Indirect Labor | 370,000.00 | |
| Insurance—Factory | 20,000.00 | |
| Indirect Raw Materials | 50,000.00 | |
| Maintenance and Repairs | 48,000.00 | |
| Miscellaneous Factory Expense | 42,000.00 | |
| Property Taxes—Factory | 15,000.00 | |
| Social Security Taxes—Factory | 30,000.00 | |
| Selling Expenses | 400,000.00 | |
| General Expenses | 200,000.00 | |
| | $8,725,000.00 | $8,725,000.00 |

**Required:**

(1) From the above information prepare a condensed profit and loss statement and balance sheet which you would be willing to incorporate in your audit report. Prepare, also, a detailed schedule showing cost of goods manufactured and sold.

(2) If replacement prices on raw materials on December 31, 19—, were 10% under the costs incurred by the company, explain how this information would affect the financial statements.

## Maud N Manufacturing Company*

Following is the trial balance of the Maud N Manufacturing Company on December 31, 19— (this year):

| | | |
|---|---|---|
| Cash | $ 7,209.15 | |
| Accounts Receivable | 84,600.31 | |
| Raw Materials, including purchases | 298,934.60 | |
| Work in Process | 92,020.02 | |
| Finished Goods | 66,098.50 | |
| Prepaid Insurance | 1,234.45 | |
| Machinery and Equipment | 375,121.11 | |
| Reserve for Depreciation | | $ 100,240.96 |
| Accounts Payable | | 64,233.25 |
| Common Stock, no-par, 20,000 shares | | 256,488.90 |
| Earned Surplus | | 133,082.51 |
| Sales | | 974,016.22 |
| Cost of Sales | 779,115.31 | |
| Materials Absorbed | | 288,854.12 |
| Direct Labor Absorbed | | 209,600.44 |
| Factory Overhead Absorbed | | 192,832.40 |
| Direct Labor | 209,600.44 | |
| Factory Overhead | 186,550.05 | |
| Salesmen's Commissions | 85,314.48 | |
| Officers' Salaries | 20,000.00 | |
| Office Rent and Expense | 3,376.20 | |
| Provision for Federal Income Taxes | 10,174.18 | |
| | $2,219,348.80 | $2,219,348.80 |

Physical inventories at cost, which were lower than market prices, were:

| | December 31 | |
|---|---|---|
| | *This Year* | *Last Year* |
| Raw Materials | $10,080.48 | $17,200.50 |
| Work in Process: | | |
| Materials | 39,604.02 | 41,236.48 |
| Direct Labor | 27,300.00 | 30,050.00 |
| Factory Overhead | 25,116.00 | 27,646.00 |
| Finished Goods: | | |
| Materials | 28,850.50 | 62,438.33 |
| Direct Labor | 19,400.00 | 49,650.00 |
| Factory Overhead | 17,848.00 | 45,678.00 |
| (Last year's inventory was sold this year.) | | |

| | |
|---|---|
| Machinery manufactured this year for own use: | |
| Materials | 3,454.63 |
| Labor | 3,800.68 |
| Overhead | 3,496.63 |
| | $10,751.94 |

Engaged in auditing the company's books, you find the foregoing figures correct with the following exceptions:

(1) Factory overhead has been absorbed during this year on the basis of 92% of direct labor which was the current ratio for last year; the factory overhead absorbed this year must be corrected by applying the actual ratio for this year. Use a percentage without a decimal fraction.

(2) Depreciation expense in factory overhead includes an allowance on machinery manufactured for own use to which the excess overhead has been added. Depreciation was computed thereon at 5% (one half the annual rate) which is the proper rate for additions made during the year. The depreciation provision must be corrected.

(3) Federal income taxes at 40% must be recomputed.

**Required:**

Prepare, in a form suitable for inclusion in an audit report:

(1) Balance sheet, December 31, 19— (this year).

(2) Profit and loss statement for this year.

(3) Cost of manufacture for this year.

## Adrienne Manufacturing Company

Following is the condensed and audited trial balance of the Adrienne Manufacturing Company for December 31 of the past calendar year:

| | | |
|---|---|---|
| Cash | $ 374,000.00 | |
| Accounts Receivable | 673,000.00 | |
| Finished Goods | 146,000.00 | |
| Work in Process | 61,200.00 | |
| Raw Materials | 120,000.00 | |
| Prepaid Expenses | 6,000.00 | |
| Office Equipment | 50,000.00 | |
| Reserve for Depreciation (10% annual rate) | | $ 20,000.00 |
| Delivery Equipment | 30,000.00 | |
| Reserve for Depreciation (25% annual rate) | | 15,000.00 |
| Machinery and Equipment | 1,500,000.00 | |
| Reserve for Depreciation (10% annual rate) | | 900,000.00 |
| Buildings | 2,000,000.00 | |
| Reserve for Depreciation (4% annual rate) | | 600,000.00 |
| Land | 100,000.00 | |
| Accounts Payable | | 200,000.00 |
| Notes Payable to Banks, Secured | | 1,000,000.00 |
| 6% Convertible Debenture Bonds Payable | | 500,000.00 |
| Unamortized Bond Discount | 10,000.00 | |
| Common Stock, 100,000 shares no-par | | 2,000,000.00 |
| Earned Deficit | 200,000.00 | |
| Sales: Jan.-Apr.: 182,000 units at $11.00<br>May-Aug.: 200,000 units at $9.00<br>Sept.-Dec.: 190,000 units at $8.00 | | 5,322,000.00 |
| Purchases: Jan.-Apr.: 200,000 units at $4.00<br>May-Aug.: 200,000 units at $3.50<br>Sept.-Dec.: 200,000 units at $3.00 | 2,100.000.00 | |
| Direct Labor | 881,600.00 | |
| Manufacturing Expenses | 986,000.00 | |
| Selling Expenses | 967,200.00 | |
| Administrative Expenses | 321,000.00 | |
| Bond Interest and Amortization | 31,000.00 | |
| | $10,557,000.00 | $10,557,000.00 |

A plan of capital and financial reorganization, approved by directors and stockholders, was to be made operative on January 1 following the date of the above trial balance. The plan included the following provisions, among others: the bonds payable were to be converted into 5% convertible preferred stock ($100.00 par) at the rate of $5,000.00 par value of bonds for $6,000.00 par value of preferred stock; the common stock was to be exchanged for 10,000 shares of new common stock of $100.00 par. Against the surplus created by this exchange two charges were to be made: (1) the earned deficit was to be written off; and (2) because it was valued at an excessively high

price, the gross value of the building and its related reserve for depreciation were to be written down by 50%.

The following information relates to the inventories of the company:

| | *Beginning of Year* | *End of Year* |
|---|---|---|
| Raw materials: 30,000 units at $4.00 | $120,000.00 | |
| 50,000 units at $3.00 | | $150,000.00 |
| Work in process: | | |
| 12,000 units ⅓ processed: | | |
| Materials: at $4.00 | $ 48,000.00 | |
| Labor: at $1.50 × ⅓ | 6,000.00 | |
| Burden: at $1.80 × ⅓ | 7,200.00 | |
| | $ 61,200.00 | |
| 16,000 units ½ processed: | | |
| Materials: at $3.00 | | $ 48,000.00 |
| Labor: at $1.50 × ½ | | 12,000.00 |
| Burden: at $1.80 × ½ | | 14,400.00 |
| | | $ 74,400.00 |
| Finished goods: | | |
| 20,000 units: | | |
| Materials at $4.00 | $ 80,000.00 | |
| Labor at $1.50 | 30,000.00 | |
| Burden at $1.80 | 36,000.00 | |
| | $146,000.00 | |
| 24,000 units: | | |
| Materials at $3.00 | | $ 72,000.00 |
| Labor at $1.50 | | 36,000.00 |
| Burden at $1.80 | | 43,200.00 |
| | | $151,200.00 |

Beginning inventories were audited values from your previous audit engagement. Audit work with respect to ending inventories was complete as to physical aspects but not as to dollar valuations.

The management of the Adrienne Manufacturing Company believed that the decline in the price of its material purchases had come to an end. Accordingly, it wished to know how its income statement for the past year would have appeared if the present $3.00 price on material purchases had been in effect throughout the year. Furthermore, for the coming year, management had negotiated a wage scale reduction of 5%; and it expected to reduce manufacturing expenses (exclusive of depreciation expense) by 10%. No change was anticipated in the amount of selling and administrative expenses.

In line with this thinking, the management of the Adrienne Manufacturing Company has asked you to prepare comparative income statements and

balance sheets for the past calendar year, set in parallel columns, to show in the first column, actual audited values for the year; and, in the second column, values giving effect to the paragraph above and the plan of capital and financial reorganization.

**Required:**

(1) Prepare the statements called for.

(2) Is it proper for an auditor to prepare the second of these statements? May he give an opinion upon it? Discuss.

# Company P

The preclosing trial balances of Company P and its subsidiary, Company S, on December 31, 1952 were:

| | *Company P* | | *Company S* | |
|---|---|---|---|---|
| Cash | $ 240,000.00 | | $ 150,000.00 | |
| Accounts Receivable-Trade | 300,000.00 | | 219,000.00 | |
| Accounts Receivable-Co. S. | 27,000.00 | | | |
| Inventory | 180,000.00 | | 120,000.00 | |
| Investment in Company S, 90%, cost | 300,000.00 | | | |
| Accounts Payable | | $ 150,000.00 | | $ 90,000.00 |
| Accounts Payable-Co. P. | | | | 27,000.00 |
| Capital Stock, $100.00 par | | 500,000.00 | | 250,000.00 |
| Surplus | | 449,500.00 | | 122,000.00 |
| Sales | | 1,200,000.00 | | 1,050,000.00 |
| Purchases | 870,000.00 | | 840,000.00 | |
| Expenses | 405,000.00 | | 210,000.00 | |
| Dividend Income | | 22,500.00 | | |
| | $2,322,000.00 | $2,322,000.00 | $1,539,000.00 | $1,539,000.00 |

Company P acquired its 90% stock investment in Company S on January 1, 1950, when the net worth of Company S was capital stock, $250,000.00; surplus, $80,000.00.

Company S sold merchandise to Company P in 1952, amounting to $150,000.00.

The new inventories on December 31, 1952, were: Company P, $330,000.00; Company S, $225,000.00. The amount of Company S merchandise in the inventory of Company P on January 1, 1952, was $60,000.00; and on December 31, 1952, $90,000.00. The rate of gross profit earned by Company P in 1951, was 41%; by Company S, $33\frac{1}{3}$%.

**Required:**

(1) Consolidated statement of profit and loss for the year 1952.

(2) Consolidated balance sheet, December 31, 1952.

(3) Consolidated statement of surplus for the year 1952. NOTE.—During the year, Company P paid cash dividends of 13% on its capital stock, and Company S paid cash dividends of 10%.

## Bradford Land Company

The Bradford Land Company purchased and developed a tract of land to be known as Bradford Hills. The cost of the land was $500,000.00 and developmental costs were expected to be as follows:

| | |
|---|---|
| Engineering and planning | $ 50,000.00 |
| Clearing, grading, landscaping | 200,000.00 |
| Water, drainage, and sewer improvements | 200,000.00 |
| Roads, bridges, sidewalks, etc. | 500,000.00 |
| Trees and shrubbery | 50,000.00 |
| | $1,000,000.00 |

The tract was subdivided into lots as follows:

300 Class A lots whose expected sales price was fixed at $4,000.00 each.
800 Class B " " " " " " " " 3,000.00 each.
1,000 Class C " " " " " " " " 2,000.00 each.

These lots were to be sold by a subsidiary company, the Bradford Hills Sales Company, on terms of at least 25% down, the balance on mortgages under deferred payment plans extending for 10 years or less. However, 10% of the gross sales price of each lot was immediately payable into a perpetual maintenance fund in charge of an independent trustee, the First National Bank. This fund was to be used for the maintenance of a small, private park located near the center of Bradford Hills.

While salesmen's commissions were fixed at 20% of the gross sales price of lots, it was agreed in writing that they were payable only in proportion to collections. Salesmen were to work on a straight commission basis with no expense allowance.

The land company charged the sales company only with lots sold. No sales were made in the first year because of developmental operations. In the second year 1,050 lots were sold. These lots were billed to the sales company as follows:

200 Class A lots at $2,000.00
250 Class B lots at $1,500.00
600 Class C lots at $1,000.00

You are auditing the accounts of the Bradford Land Company and its subsidiary, the Bradford Hills Sales Company. The trial balances of the general ledgers of the two companies on December 31, 19— (second year), are as follows:

| | *Bradford Land Co.* | | *Bradford Hills Sales Co.* | |
|---|---|---|---|---|
| Cash | $ 265,000.00 | | $ 70,500.00 | |
| First National Bank, trustee's cash, 1,050 lots at $200.00 | | | 210,000.00 | |
| Cash Received on Sales, 25% | | | | $ 687,500.00 |
| Bradford Hills Sales Company | 1,000,000.00 | | | |
| Notes Receivable, Bradford Hills Sales Company | 500,000.00 | | | |
| Notes Receivable Discounted | | $ 500,000.00 | | |
| Investment in Bradford Hills Sales Company, 1,000 shares of which 900 shares have been paid for in full at par | 90,000.00 | | | |
| Equipment (10-year life) | 20,000.00 | | 10,000.00 | |
| Reserve for Depreciation | | 2,000.00 | | 1,000.00 |
| Subscriptions Receivable to Capital Stock, 100 shares | | | 10,000.00 | |
| Land | 500,000.00 | | | |
| Engineering and Planning | 50,000.00 | | | |
| Clearing, Grading, Landscaping | 125,000.00 | | | |
| Water, Drainage, and Sewer Improvements | 100,000.00 | | | |
| Roads, Bridges, Sidewalks, etc. | 325,000.00 | | | |
| Trees and Shrubbery | 20,000.00 | | | |
| Accounts Payable | | 30,000.00 | | |
| Bradford Land Company | | | | 1,000,000.00 |
| Notes Payable | | 200,000.00 | | |
| Notes Payable to Bradford Land Company | | | | 500,000.00 |
| Capital Stock, $100.00 par | | 1,000,000.00 | | 100,000.00 |
| Sales | | 1,375,000.00 | | |
| Cost of Sales | | | 1,375,000.00 | |
| Depreciation Expense (on personal property) | 2,000.00 | | 1,000.00 | |
| Sundry Expense, Interest, Taxes (other than income), etc. | 110,000.00 | | 62,000.00 | |
| Payments to Salesmen | | | 550,000.00 | |
| | $3,107,000.00 | $3,107,000.00 | $2,288,500.00 | $2,288,500.00 |

On the average the "equipment" of the companies was one year old. Income taxes were estimated at 40% of annual consolidated net income. Total developmental costs were still estimated at $1,000,000.00.

**Required:**

(1) Prepare the audited consolidated financial statements which you would construct for the Bradford Land Company.

(2) *Alternatively*, prepare the audited consolidated financial statements which you would construct for the Bradford Land Company, the income to be calculated as being realized proportionate to collections.

(3) Which of these statements of income correctly reflects the net income or loss earned by the consolidated organization for the year? Which statement should be recommended for the use of your client? Discuss.

(4) What are some of the problems of verification present in this audit engagement?

# 17. AUDIT REPORTS

## Ohio Manufacturing Company*

You have been engaged to audit the books of the Ohio Manufacturing Company. You are required to: (a) Prepare journal entries and explanations; (b) write audit report explaining your verification and adjustment of each asset and liability; (c) prepare a balance sheet, December 31, 1951, properly classified. You may make any reasonable assumptions when necessary provided these are stated in your solution.

*Petty Cash:*

Cash on hand, $195.00, vouchers signed for the following: freight and express, $15.00; office salaries, $20.00; postage, $12.00; unaccounted for, $8.00, counted as of December 31, 1951.

*Cash on Deposit:*

Audit commenced January 31, 1952. The bank statement on that date showed a balance of $12,210.00. Checks not presented to the bank for payment: #210 for $150.00, #212 for $42.00, and #213 for $50.00. During the period from December 31, 1951 to January 31, 1952, the following transactions occurred:

| | |
|---|---|
| Total deposits | $ 12,052.50 |
| Total checks drawn | 7,640.00 |
| Bank charges | 12.00 |

*Accounts Receivable:*

| | |
|---|---|
| Debit balances | 189,755.55 |
| Credit balances | 2,755.60 |

The debit balances included the following:

| | |
|---|---|
| Officer's personal account | 10,000.00 |
| Employees' accounts | 3,205.00 |
| Due on stock subscriptions | 15,000.00 |
| Consignment accounts (credited to sales at cost) | 22,450.00 |

The allowance for bad accounts has been estimated to be $22,000.00. Notes receivable were $9,000.00. Consignee reported no sales to December 31, 1951.

*Inventory:*

| | |
|---|---|
| Finished goods | 68,880.00 |

| | |
|---|---|
| Work in process: | |
| Materials | 9,200.00 |
| Labor | 4,500.00 |
| Burden, 100% of labor | 4,500.00 |
| Raw materials | 28,500.00 |
| Office supplies | 2,700.00 |

An invoice of $3,300.00 for materials in transit December 31, 1951, has been included in the accounts payable but not in the inventory.

Included in sales is $6,000.00 of finished goods also included in inventory. Billing was dated December 28, 1951.

*Machinery and Equipment:*

Factory building and equipment cost $150,000.00. There has been set up a depreciation reserve of $45,000.00. An appraisal made shows the replacement cost as $220,000.00 and the depreciated sound value at $180,000.00.

*Building:*

There is an account called "New factory building" with a balance of $28,000.00. This building is now being used but you find in the minutes that the construction contract called for a price of $35,000.00.

*Treasury Stock:*

The company acquired (on January 1, 1951) 200 shares of its own stock for $17,000.00 and received an 8% dividend declared December 28, 1950 to stockholders of record January 2, 1951.

*Insurance:*

Life insurance on officers of the company; cash surrender value January 1, 1951, $3,200.00; premium paid December 31, 1951, $780.00; additional surrender value, $300.00.

Unexpired general insurance, $2,850.00.

*Accounts Payable, etc.:*

| | |
|---|---|
| Trade creditors | $48,650.00 |
| Accrued payroll | 3,850.00 |
| Income taxes | 6,684.00 |
| Damage claim (in litigation) | 2,500.00 |
| Notes receivable discounted | 6,000.00 |
| The bank reported that $1,500.00 of these notes was paid prior to December 31, 1951. | |
| Accrued attorney's fees on damage claim | 350.00 |

*Bonds Payable:*

Bond issue, dated June 1, 1946, \$100,000.00 6%, 20-year; sinking fund established to retire these bonds. Indenture provided that the trustee could purchase these bonds whenever they could be obtained at a price not to exceed 94, and the trustee purchased and retired bonds at a face value of \$20,000.00 at 93 on June 1, 1951.

*Capital Stock:*

Outstanding stock, \$100.00 par, 2,500 shares has been changed to 7% preferred stock, \$100.00 par, 1,500 shares, and 2,000 shares of no-par value. The transfer has been made and new stock is outstanding as of December 31, 1951. The transfer was made on the basis of 1½ shares of preferred and 2 shares of no-par stock for each 2½ shares of the original issue.

## Caroline Dress Company

From the following information prepare a complete report covering your audit of the books of the Caroline Dress Company of Charlotte, N. C., for the year ending December 31, 19— (last year).

The Caroline Dress Company was acquired by its present owners on January 1 (two years ago) as the result of the purchase of an existing business for a cash consideration of $750,000.00. The money was paid by present stockholders of the Caroline Dress Company to the old stockholders.

The year under audit, therefore, was the second year of operation of the Caroline Dress Company under its new ownership. The accounts for the first year were not audited. The present engagement is your first with this company.

The Caroline Dress Company does not manufacture dresses; it is a sales organization. The company, however, absorbs most of the output of five small dress factories in and near Charlotte. The company therefore dominates the manufacturing policies of these dress factories.

Dresses are sold in four major sales areas: Atlanta, Cincinnati, Memphis, and Washington, D.C.

The trial balance for December 31 of the audit year has been prepared by the company's head bookkeeper. The trial balance for December 31 of the previous year is the final, adjusted trial balance for the year in question and, although an unaudited trial balance, its values are to be accepted by you as substantially correct for the purpose of your audit. The management of the Caroline Dress Company is unwilling to pay the extra fee which would be involved for audit work relating to prior years. The present engagement is for a flat fee of $2,000.00.

You are to prepare a first class audit report. You may make whatever assumptions are necessary to cover any aspect of the following information which you may consider to be incomplete. Your working papers should be well constructed, and they should show "what was done" in the verification of assets and equities. For the purpose of the audit report, it will be satisfactory to have all figures correct to the nearest dollar.

The company's system of internal check was examined by you and was found to be reasonably satisfactory. However, you observe that none of the company's employees or officers were bonded, that the bank statement was reconciled monthly by the cashier, and that the accounts receivable ledger was freely accessible to all employees of the general office.

Your audit work in the office of your client commenced on Wednesday, March 1, 19—, and it was completed at the close of March 10, 19—.

### Trial Balances, December 31

| | *Last Year* | | *Previous Year* | |
|---|---|---|---|---|
| Cash | $ 100,084.00 | | $ 360,467.00 | |
| Petty Cash | 500.00 | | 500.00 | |
| Notes Receivable | 44,166.00 | | 45,008.00 | |
| Notes Receivable Discounted | | $ 10,994.00 | | |
| Accounts Receivable | 407,660.00 | | 291,972.00 | |
| Reserve for Bad Debts | | 21,346.00 | | $ 15,788.00 |
| Inventories: | | | | |
| Merchandise | 285,060.00 | | 308,133.00 | |
| Advertising and Office Supplies | 12,520.00 | | 12,520.00 | |
| Prepaid Insurance | 694.00 | | 772.00 | |
| Bond Investments | 100,000.00 | | | |
| Bond Interest Receivable | 1,667.00 | | | |
| Stock in Nuway Products Company | 100,000.00 | | | |
| Life Insurance—Officers | 20,564.00 | | 10,282.00 | |
| Delivery Trucks | 33,000.00 | | 33,000.00 | |
| Reserve for Depreciation—Delivery Trucks | | 33,000.00 | | 33,000.00 |
| Fixtures and Racks | 28,906.00 | | 22,128.00 | |
| Reserve for Depreciation—Fixtures and Racks | | 11,957.00 | | 8,638.00 |
| Office Furniture and Equipment | 6,400.00 | | 6,150.00 | |
| Reserve for Depreciation—Office Furniture and Equipment | | 1,705.00 | | 1,090.00 |
| Goodwill | 100,000.00 | | 100,000.00 | |
| Option | 1,000.00 | | | |
| Accounts Payable | | 187,340.00 | | 202,846.00 |
| Notes Payable | | 150,000.00 | | 120,000.00 |
| Income Taxes Payable | | | | 62,004.00 |
| Social Security Taxes Payable | | 2,980.00 | | 2,890.00 |
| Withholding Income Taxes Payable | | 4,224.00 | | 4,002.00 |
| Common Stock, $100.00 par | | 600,000.00 | | 600,000.00 |
| Treasury Stock, 50 shares acquired September 9, at cost | 4,500.00 | | | |
| Earned Surplus | | 100,001.00 | | 1,715.00 |
| Sales | | 1,911,304.00 | | 2,069,768.00 |
| Returned Sales | 22,604.00 | | 20,260.00 | |
| Sales Discounts | 28,500.00 | | 30,508.00 | |
| Purchases | 1,269,116.00 | | 1,358,058.00 | |
| Returned Purchases | | 7,228.00 | | 3,354.00 |
| Purchases Discounts | | 20,462.00 | | 21,802.00 |
| Freight In | 82,118.00 | | 87,636.00 | |
| Advertising | 50,678.00 | | 35,234.00 | |
| Delivery Expense | 12,002.00 | | 11,488.00 | |
| Salesmen's Commissions | 102,530.00 | | 113,960.00 | |
| Salesmen's Salaries | 83,116.00 | | 86,996.00 | |
| Traveling Expense | 35,610.00 | | 34,188.00 | |
| Bad Debts | 18,602.00 | | 20,190.00 | |
| Depreciation Expense | 3,934.00 | | 3,934.00 | |
| Insurance Expense | 2,948.00 | | 3,106.00 | |
| Office Expense | 9,132.00 | | 8,148.00 | |
| Office Salaries | 46,874.00 | | 40,224.00 | |
| Office Supplies | 3,138.00 | | 2,586.00 | |
| Rent | 30,000.00 | | 30,000.00 | |
| Taxes: | | | | |
| Income | 9,152.00 | | 62,004.00 | |
| Social Security | 3,866.00 | | 3,751.00 | |
| Miscellaneous | 6,758.00 | | 6,014.00 | |
| Interest Income | | 8,261.00 | | 3,218.00 |
| Interest Expense | 3,403.00 | | 898.00 | |
| | $3,070,802.00 | $3,070,802.00 | $3,150,115.00 | $3,150,115.00 |

*Cash:*

The balance of $100,084.00 does not include collections of $2,228.00 received from customers (1- to 60-day-old accounts) after banking hours on December 31, 19—. The Cash account balance was reconciled with the bank statement; and the bank balance was confirmed independently.

Check #1074, issued on February 8 (23 months ago) for $14.00 in favor of Hartley & Haille (Wrayswood, Georgia) is still outstanding. The payee replies to the auditor's letter: "We deposited this check on February 15."

Up until October 14 of the audit year, two bank accounts were carried. On that date the Fidelity State Bank closed, tying up a balance of $7,652.00 (which figure is included in the Cash account balance above). The receiver of the bank declines to estimate the probable liquidating dividend. The bank is not a member of the Federal Deposit Insurance Corporation.

Check #18741 for $12,824.00 was issued on December 1 of the audit year in favor of Sears & Ward, mail order house, to accompany a bid given that company to supply a quantity of dresses per their specifications. An account with Sears & Ward was opened in the Accounts Receivable subsidiary ledger. The amount of the bid was $128,240.00, the successful bidder to be announced and contract awarded on January 18, 19—. (During your audit, you find that the award was made to another company and that check #18741 was returned by Sears & Ward on January 22.)

*Petty Cash:*

The composition of this fund on December 31, 19— was:

| | |
|---|---|
| Coin and currency | $247.59 |
| Traveling expense report, #370 | 94.00 |
| Receipts covering advances to officers during the month of December | 112.00 |
| Postage stamps | 46.41 |
| | $500.00 |

*Notes Receivable:*

These trade notes receivable were as follows:

| | *Amount* | *Dated* | *Term* | *Interest* |
|---|---|---|---|---|
| Beyer & Beyer | $ 4,174.00 | Nov. 7 | 60 days | 6% |
| Jones, Vee K. | 7,952.00 | Dec. 2 | 30 days | none |
| Layman, G. L. | 5,686.00 | Dec. 14 | 30 days | none |
| McClure & Son | 3,634.00 | Oct. 10 (3 years ago) | 3 months | 8% |
| Reed, Boyd L. | 9,678.00 | Aug. 5 | 120 days | 6% |
| Stewart, F. W. | 4,222.00 | Dec. 29 | 30 days | none |
| Wills & Company | 6,820.00 | Nov. 30 | 30 days | 6% |
| Winston, L. J. | 2,000.00 | July 1 | Demand | 4% |
| | $44,166.00 | | | |

The Beyer and Wills notes have been discounted at the Pine State National Bank. The Jones note is at the same bank for collection.

The McClure note is in difficulty. Only the interest and $20.00 was paid when the note came due for payment; monthly payments of $20.00 have been made since. Interest has been paid up to and including December 10 (of the audit year). McClure & Son, in the opinion of the president of the Caroline Dress Company, are honest enough and, ultimately, may be expected to pay the whole note—that is "unless other creditors should press them too much."

The Reed note is expected to be paid on or before March 10.

The Winston note cannot be found for inspection by the auditor. The treasurer advises that the note "must have been mislaid somewhere." You communicate with L. J. Winston by letter; his reply confirms the treasurer's description of the note.

Except as modified by the above comments, all notes are considered good and have been verified by you. Collections of interest on notes receivable amounted to $3,236.00 for the year, all properly credited to Interest Income.

*Accounts Receivable:*

Terms of sale are generally 2/10, n/60. The accounts receivable have been aged and the following schedule prepared:

| | | *Estimated Uncollectibility of Trade Accounts Receivable* |
|---|---|---|
| 1–60 days old | $288,010.00 | 1% |
| 61–90 days old | 92,428.00 | 2% |
| 4– 6 months old | 15,978.00 | 15% |
| 7– 9 months old | 6,962.00 | 25% |
| 10–12 months old | 2,824.00 | 50% |
| Over 12 months old | 1,458.00 | 100% |
| | $407,660.00 | |

Included in these accounts receivable were:

| | |
|---|---|
| Advances to salesmen (2–3 months old) | $ 6,428.00 |
| Advances to officers and employees (unsecured but considered good, 1–60 days old) | 12,428.00 |
| Advances to dress factories, 1–60 days old—these advances to be applied against billings for spring deliveries | 70,000.00 |

Nontrade accounts receivable were confirmed; trade accounts receivable were not, largely because of the unwillingness of the Caroline Dress Company to assume the costs involved.

A study of 663 customers' accounts, as summarized by one of your assistants follows:

| *Number of Dresses Sold Per Customer During 19—* | *Number of Customers* | *Number of Orders* | *Number of Dresses* |
|---|---|---|---|
| Under 50 | 286 | 529 | 6,012 |
| 50– 99 | 141 | 483 | 12,267 |
| 100–299 | 101 | 507 | 20,547 |
| 300 and over | 135 | 1,362 | 54,759 |
| | 663 | 2,881 | 93,585 |

*Reserve for Bad Debts:*

For the past two years, 1% of net sales (after returns and cash discounts) was credited to this account as a provision for uncollectible accounts. Practice of the company has been to charge all known bad debt accounts to the Reserve for Bad Debts account. Once written off, no further attempts at collection are made.

During the calendar year under audit, worthless trade accounts receivable were written off by debits to the Reserve for Bad Debts account and credits to Accounts Receivable. Of the accounts written off, $3,526.00 were accounts receivable arising out of the sales of the current audit year.

*Inventory of Merchandise:*

The new physical inventory on December 31, 19— was taken by employees of the company and it was not supervised or observed by you. It is valued at invoice cost, $246,002.00. However, it does not include two purchases in transit—one for $3,001.00 (f.o.b. destination) and the other for $6,050.00 (f.o.b. shipping point). Freight on these shipments will approximate 6% of invoice cost, both shipments moving forward "freight collect."

Prices employed in costing the inventory check quite satisfactorily with prices on purchase invoices of the last three months. All dresses were stated by the management to be merchandise acquired during the year and to be currently salable. Questioned as to obsolete merchandise, the president advises that "some of the styles of dresses on hand (of which there were more than 500 styles and designs) are becoming increasingly difficult to move; if this is considered a sign of out-of-date merchandise, the estimate would be about 5% of the actual inventory on hand."

You are advised "that the costs attaching to the inventory are about the same costs on which we are figuring our business for the first half of the new year." Questioned as to the trend of prices, the president advises "that selling prices have slipped somewhat over the first two months of the new year and we have been compelled to shade prices with considerable frequency."

Market prices for dresses comparable to those sold by the company were not readily obtainable but you observe that the prices quoted to Sears & Ward on December 1, 19—, were about 16% under the prices quoted on a similar,

but unsuccessful, bid a year ago. Your study of list prices in several manufacturers' catalogs indicates that present price quotations are from 12 % to 20% under the prices of a year ago. Any suggestion on your part for a reduction in the value of the inventory is likely to be strenuously resisted by the company's management.

*Inventory of Advertising and Office Supplies:*

The physical inventory on December 31, 19— (of the audit year), amounts to $10,010.00 valued at estimated cost. This compares with $12,520.00 on hand December 31, one year ago. The new inventory consists of office supplies, $1,001.00, and advertising supplies, $9,009.00 (of which one-third represents advertising materials applicable to the first half of the audit year but never used). All other supplies are reasonably current.

*Prepaid Insurance:*

Aside from "Life Insurance, Officers" the company carried fire insurance, and public liability and property damage on its automobiles. The insurance coverage appears adequate. All policies were inspected by you and the prepaid insurance of $694.00 appears correct.

*Bond Investments:*

On January 1 of the year under audit, the company purchased the following securities:

| | | *Market Price on* | |
|---|---|---|---|
| | *Par* | *Jan. 1* | *Dec. 31* |
| American Television 5's of 1980, F & A | $ 50,000.00 | 98 | $106\frac{1}{4}$ |
| Morris & Co., $4\frac{1}{2}$'s of 1969, J & J | 10,000.00 | 74 | 78 |
| N.J. Central 6's of 1970, M & N | 10,000.00 | 86 | 54 |
| Southeastern Electric 6's of 2025, M & S | 20,000.00 | $76\frac{3}{4}$ | $69\frac{1}{2}$ |
| Texas Paper 5's of 1974, A & O | 10,000.00 | $72\frac{1}{2}$ | 93 |
| | $100,000.00 | | |

All of these securities were kept in the company's office vault and were inspected by you. There were no uncashed matured interest coupons. The difference between par and the cost of the bonds was credited to Earned Surplus; and the accrued interest at purchase date, $1,667.00, was debited to Bond Interest Receivable.

All of these bonds were purchased as short-term investments of working capital.

*Stock in Nuway Products, Inc.:*

This represents an investment in 1,000 shares made on August 1 of the audit year at a price of 100. You examine stock certificates #21–30 but are

refused any information regarding the purpose or nature of the investment other than that it is "long-term" and "sound." The stock is not listed on any exchange.

*Life Insurance—Officers*—$20,564.00:

This balance represents premiums paid on life insurance policies in favor of the company on lives of certain officers. Cash surrender values of these policies amounted to $9,458.00 as of December 31 of the audit year; and $7,956.00 for December 31 of the previous year. Premiums for the past two years have been capitalized; in earlier years they were expensed.

*Fixed Assets:*

| *Fixed Asset* | *Acquired* | *Depreciation* *Rate Used on Books* | *Depreciation* *Calculated Against* | *Estimated Composite Life Remaining as of December 31 of audit year* |
|---|---|---|---|---|
| Delivery Trucks | January 1, five years ago | 33⅓% | Original cost | 1 year |
| Fixtures and Racks | Various dates | 15% | Balance at beginning of year | 4 years |
| Office Furniture and Equipment | Various dates | 10% | Balance at beginning of year | 6 years |

On June 10, new fixtures and racks were installed to expedite, modernize, and more effectively control the flow of incoming and outgoing merchandise, $6,778.00. On May 28, a Burroughs electric adding machine was purchased, list price $400.00. Against this invoice price, however, a trade-in allowance of $150.00 was received on a hand-operated adding machine; the machine traded in had been purchased originally for $240.00 and was only 18 months old.

*Goodwill:*

This asset does not appear to have been purchased. On the authority of an act of the board of directors, as shown in the minute book, goodwill was recorded on the books ten days before a stock dividend of 20% on December 31, 19— (three years ago).

*Option:*

On December 14 of the year under audit, a check for $1,000.00 was given to the Arden Dress Company of Gastonia, N. C., in return for an option to purchase the business of this company. The option was good up to and including the following June 30. As soon as your present audit engagement has been completed, the Caroline Dress Company has requested

you to examine the Arden Dress Company. Your audit report is expected to be helpful in arriving at the company's decision on the option.

*Notes Payable:*

The account for this liability was:

NOTES PAYABLE

| | | | | | |
|---|---|---|---|---|---|
| Feb. 28 | Dexter Finance Co., 7% | 20,000.00 | Jan. 1 | Balance | 120,000.00 |
| Apr. 16 | Pine State Bank, 6% | 30,000.00 | Aug. 17 | Dexter Finance Co. | 30,000.00 |
| June 15 | Pine State Bank, 6% | 70,000.00 | Nov. 14 | Pine State Bank | 50,000.00 |
| Dec. 17 | Dexter Finance Co., 7% | 30,000.00 | Dec. 9 | Pine State Bank | 50,000.00 |
| | | | Dec. 17 | Dexter Finance Co. | 50,000.00 |

The balance of the account, $150,000.00, represented the three following notes:

| *Amount* | *Dated* | *Term* | *Interest* | *In Favor of* |
|---|---|---|---|---|
| $50,000.00 | Nov. 14 | 90 days | 6% | Pine State National Bank. |
| 50,000.00 | Dec. 9 | 120 days | 6% | Pine State National Bank. |
| 50,000.00 | Dec. 17 | 4 months | 7% | Dexter Finance Company. |

The last-named note represented a renewal and an increase in a note for $30,000.00, originally dated August 17; accrued interest on this note was paid December 17.

No interest has been paid on the three notes payable now outstanding.

*Income Taxes Payable:*

Income taxes, paid on March 15 of the audit year, amounted to $62,004.00. However, on the following November 23, additional income taxes of $9,152.00 (applicable to the same year) were paid because of an error in the original return. For the purpose of this problem, income taxes for the audit year and the previous year may be assumed as 40%.

*Social Security Taxes Payable:*

You examine the payroll records for January, August, and December, and find calculations to be correct. The social security taxes payable of $2,980.00 on December 31 consist of: 3% O.A.B. tax for the year, $2,899.00, and 2% unemployment taxes for the month of December, $81.00.

*Common Stock:*

Authorized and issued 6,000 shares, $100.00 par. Closing quotations, December 31, 19—, were 81⅞. The stock certificate book was inspected by you and found to be correct. An examination of the minute book revealed that directors had declared a cash dividend of 5% on December

20 of the year of audit, payable January 15, 19—, to stock of record, December 31, 19—.

*Earned Surplus:*

This account, for the past two years, appeared on the books as follows:

EARNED SURPLUS

| | | | | | |
|---|---|---|---|---|---|
| *(previous year)* | | | *(previous year)* | | |
| June 30 | Cash dividend, 5% | 30,000.00 | Jan. 1 | Balance | 76,715.00 |
| Oct. 31 | Special cash dividend, 2½% | 15,000.00 | Dec. 31 | Net income | 115,886.00 |
| Dec. 31 | Cash dividend, 5% | 30,000.00 | | | |
| | Balance | 117,601.00 | | | |
| | | 192,601.00 | | | 192,601.00 |
| *(last year)* | | | *(last year)* | | |
| June 30 | Cash dividend, 5% | 30,000.00 | Jan. 1 | Balance | 117,601.00 |
| | | | 1 | Discount on bonds | 12,400.00 |

*Miscellaneous Information:*

An analysis of 2,051 sales orders was made as follows:

| *Number of Orders* | *Size of Order* | *Number of Dresses* |
|---|---|---|
| 932 | 0– 25 dresses | 10,277 |
| 504 | 26– 50 " | 15,548 |
| 354 | 51–100 " | 29,813 |
| 261 | Over 100 " | 69,205 |
| 2,051 | | 124,843 |

An analysis of purchases as to the number of styles purchased (indicated by figures in parentheses) and quantities, by factories, was as follows:

| | *Dresses per Style* | | | | | |
|---|---|---|---|---|---|---|
| *Factory* | *0–25* | *26–50* | *51–250* | *251–500* | *501–2,500* | *Over 2,500* |
| #1 | | | (1) 207 | (3) 1047 | (4) 6167 | |
| #2 | (21) 300 | (20) 741 | (16) 1865 | (9) 3066 | (4) 2752 | |
| #3 | (26) 294 | (4) 135 | (24) 3540 | (14) 4897 | (21) 20827 | (12) 90247 |
| #4 | (51) 650 | (35) 1245 | (48) 6418 | (20) 7040 | (55) 66189 | (14) 62122 |
| #5 | (51) 628 | (21) 698 | (26) 3035 | (12) 4693 | (29) 28908 | (2) 8276 |

An analysis of the November sales of the Caroline Dress Company by sales areas yielded the following percentages:

| | *Atlanta* | *Cincinnati* | *Memphis* | *Washington, D.C.* |
|---|---|---|---|---|
| Sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Gross profit before markdowns | 12.7 | 15.7 | 14.8 | 18.3 |
| Markdowns and discounts | 0.8 | 2.1 | 3.0 | 2.6 |
| Salesmen's expenses | 8.2 | 10.4 | 7.3 | 8.4 |
| Other expenses | 4.7 | 4.4 | 3.1 | 3.7 |
| Net profit (loss) | (1.0%) | (1.2%) | 1.4% | 3.6% |

Comparing selling prices with purchase costs (analyzed by factories), the cost of dresses purchased shows the following gross profit percentages applicable:

| *Factory* | *Loss* | *Break-Even* | *0-5%* | *5-10%* | *10-15%* | *Over 15%* | *Quantity Totals* |
|---|---|---|---|---|---|---|---|
| #1 | | | | | | 7,421 | 7,421 |
| #2 | | | 933 | 336 | 2,964 | 4,491 | 8,724 |
| #3 | 48,437 | 7,637 | 30,574 | 13,854 | 19,438 | | 119,940 |
| #4 | | | | 77,220 | 5,023 | 61,421 | 143,664 |
| #5 | | | | | | 46,238 | 46,238 |
| | 48,437 | 7,637 | 31,507 | 91,410 | 27,425 | 119,571 | 325,987 |

Further analysis reveals the following information:

| *Selling Prices* | *Number of Dresses* | | *Volume in Dollars* | | *Gross Profit* |
|---|---|---|---|---|---|
| Under $2.00 | 49,251 | 15.1% | $ 80,620.00 | 4.2% | (11.4%) |
| $2.00-$3.99 | 66,487 | 20.4 | 235,728.00 | 12.3 | (1.4) |
| $4.00-$5.99 | 90,324 | 27.7 | 447,034.00 | 23.4 | 16.6 |
| $6.00-$7.99 | 24,371 | 7.5 | 375,644.00 | 19.7 | 28.2 |
| Over $8.00 | 95,554 | 29.3 | 772,278.00 | 40.4 | 40.1 |
| | 325,987 | 100.0% | $1,911,304.00 | 100.0% | 25.65% |

A study of the sales of four typical salesmen of the Atlanta area yielded the following information:

| *Salesmen* | *Sales* | *Gross Profit* | *Total Expense* | *Number of Orders* |
|---|---|---|---|---|
| Gibbs, J. L. | $36,325.00 | $5,745.00 | $2,901.00 | 343 |
| Martin, S. E. | 52,276.00 | 4,762.00 | 4,152.00 | 412 |
| Heffernan, T. J. | 26,619.00 | 4,468.00 | 3,596.00 | 270 |
| March, F. G. | 41,008.00 | 4,921.00 | 3,668.00 | 375 |

# INDEX